Hot topics in European treasury

PETER MATZA REPORTS FROM MUNICH, WHERE THE LATEST TALKINGTREASURY CONFERENCE GOT TO GRIPS WITH LIQUIDITY, INVESTMENT, IFRS 7 AND DERIVATIVES.

Each ***talkingtreasury*** event consistently adapts to the local treasury environment. In the ACT Middle East (ACTME) region, they reflect the mix of those corporates already exposed to comprehensive treasury management and a broader audience experienced in financial management but perhaps lacking specific treasury management skills. The European audience by contrast has the relevant experience and so is prepared to engage with the detailed minutiae of financial management and appreciates a wider political, regulatory and legal framework.

The most recent event in Europe was held for the first time in Munich, Germany, in co-operation with the VDT (German Association of Treasurers). The event, which was sponsored by JPMorgan Asset Management, attracted a wide range of participants from Germany's elite corporates, such as Bayer, Porsche, Linde and BMW. Also present were representatives from non-German corporates such as ABB, Akzo Nobel and Richemont International. A full list of panel speakers is given in Box 1 opposite.

The main themes of the day were funding and liquidity, cash and short-term investment management, financial accounting and reporting, and over-the-counter (OTC) derivatives and the future of hedging. Each topic was addressed by a mixed panel of corporates and industry experts with very lively interaction with the audience!

FUNDING AND LIQUIDITY The first session of the day looked at the difficulties and constraints on treasurers in ensuring their businesses have sufficient liquidity and credit on hand. This raised an interesting question about optimising the balance sheet in an environment of very low returns on cash and whether retaining substantial cash balances exposes a corporate to potential predatory M&A activity. The view was that the outcome depends on the type of industry and perhaps the maturity of the business but it provided considerable food for thought and discussion.

There was general agreement that larger, investment-grade businesses were exposed to pricing issues but that access to credit (or equity) was a real issue lower down the size and credit scale.

From an international viewpoint, managing liquidity in some markets has become harder and treasurers were advised to pursue policies to enhance cash visibility and access to cash. In addition there was considerable unhappiness expressed about the volume of information being required by all stakeholders, not just lenders, and whether this was actually helping bankers and others better understand corporates; the general feeling seemed to suggest not!

CASH AND SHORT-TERM INVESTMENT MANAGEMENT The second topic of the day provoked plenty of debate among the panel and the audience about treasury management practice, use of resources and general investment policy. The changing bank market and the need to look at counterparty risk was given a good airing.

Considerations of investment policy were based on active diversification of investment risk versus taking a portfolio approach to systemic risk. Is investing with a group of, say, any 10 A rated banks or a AAAm diversified fund a more practical strategy than using internal resources to construct a risk monitoring system for in-house investment?

As for tactical investment, security and liquidity were considered to be far above yield in importance although there was some support for a modest lengthening of duration to generate additional yield (see Figure 1 on page 30).

There was also debate on the principle of whether treasurers should look at net positions or gross cash/debt, which is particularly acute when considering the carry cost between cash and debt. Some concern was also expressed about accounting issues for investments held longer than three months being viewed as "not liquid" and therefore having a negative effect on ratios and covenants.

Box 1: The conference speakers

Chair: **Jochen Stich**, managing director of Porsche Corporate Finance and a VDT board member

■ **FUNDING AND LIQUIDITY IN THE NEW LANDSCAPE**
Chair: **Peter Matza**, ACT
Panel: **Ellen Cornelissen**, director treasury Europe, Aleris Europe
John McAnulty, group treasurer, Richemont International
Thomas Neidert, group treasurer, Qiagen
Erhard Wehlen, head of group treasury, Linde

■ **DUE DILIGENCE PROCESSES**
Chair: **Kathleen Hughes**, head of global liquidity, EMEA, JP Morgan Asset Management
Panel: **Carl Hoestermann**, head of corporate finance, Hochtief
John Krum, head of group treasury operations, ABB
Peter van Rood, corporate director treasury, Akzo Nobel

■ **FINANCIAL ACCOUNTING**
Chair: **Sebastian Di Paola**, partner, PricewaterhouseCoopers
Panel: **Bernd Hacker**, professor for accounting, University of Applied Sciences, Rosenheim, and IFRIC member
Heli Manner, senior manager financial statements, ProSiebenSat.1 Media
Tobia Pfuderer, senior treasurer, Claas

■ **THE FUTURE OF HEDGING RISKS**
Chair: **Christian Held**, head of corporate treasury, Bayer
Panel: **Thomas Frings**, corporate finance and treasury director, Celesio
Roland Kern, head of treasury, Deutsche Lufthansa
Carsten Rueth, vice president corporate finance, Schaeffler

Figure 1: Where would your organisation be willing to take on additional risk to increase yield?

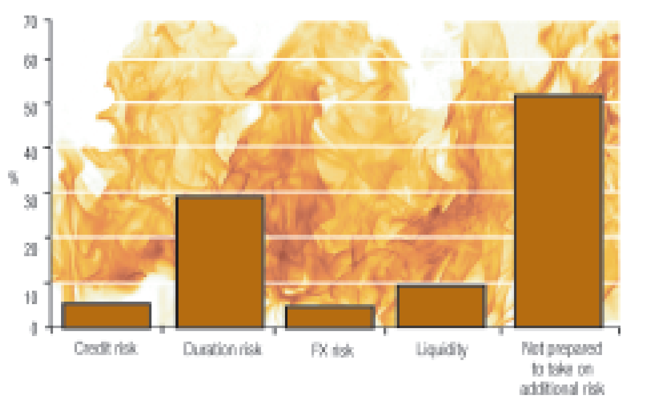


Figure 2: Are accounts providing the right information for shareholders, stakeholders and other users?

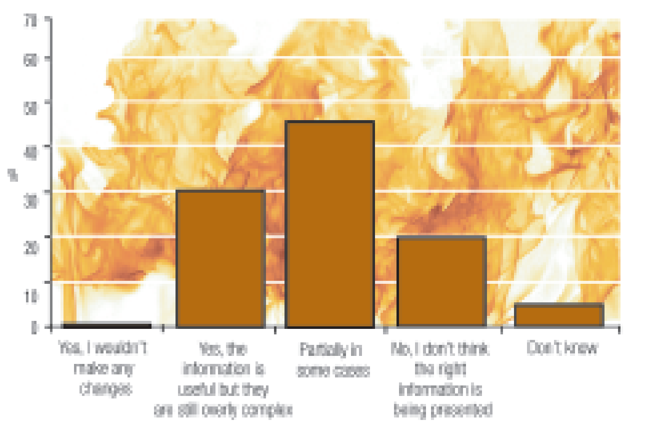
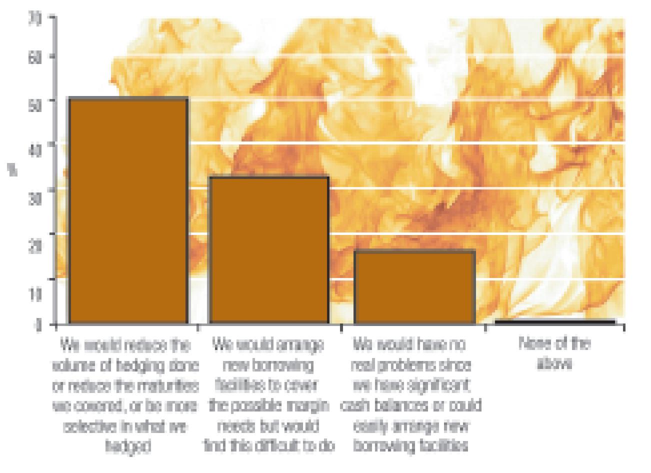


Figure 3: If all OTC derivatives were subject to cash margining how would you cope with the demand for cash?



ACCOUNTING The accounting session that followed focused on the effectiveness test regime, documentation requirements, IFRS 7 disclosures and the balance between economic outcomes and accounting movements. It seems clear that continental European corporates have as many difficulties in understanding the underlying accounting principles and the various overlay interpretations of their auditors as those elsewhere. Corporates want accounting rules that reflect the reality of economic transactions so that treasurers are not faced with having to create hedging strategies that are a hybrid between accounting interpretations and economic impact.

Accounts can be valuable as a communications tool to stakeholders, especially investors – whether debt or equity. Treasurers frequently complain that investors tend to strip out much of the accounting presentation in the accounts to focus on cash-impact strategies. The consensus was that suggested improvements to the rules would be generally welcomed, at least by more savvy investors and analysts (see Figure 2).

DERIVATIVES Delegates then turned their attention to the current political and regulatory proposals for OTC derivatives. Delegates were brought up to date with the concerted efforts of the ACT and the EACT (see URL below) and others to influence the proposals. What became clear in the discussion was that efforts to influence the political process are also needed from individual treasurers and their own companies' networks.

The most serious concerns that delegates had were that the regulators had initially ignored the corporate sector and what the practical implications of dealing derivatives on exchanges were, especially the collateral issue. The link with the previous discussion on accounting was made by delegates suggesting that they would seriously consider minimising their hedging to the protection of volatile real cash impacts of risk exposures because of the additional costs of exchange and collateral management (see Figure 3). The hope is that if the OTC proposals force treasurers down the exchange route, then accounting will get closer to economic outcomes to help corporates target the most effective hedging techniques.

The meeting closed with a presentation from Torsten Hinrichs, managing director of Standard & Poor's, who gave his views on the current economic outlook and the likely impact on ratings. He predicted a modest recovery in the US/Europe and Japan, with emerging economies growing faster, although cramped consumer spending and tight lending conditions mar the picture in Europe.

S&P sees corporates focusing on more conservative financial policies, preservation of cash and building cash balances (with stringent cost and capex management), with the low level of M&A activity in 2009 picking up in 2010.

It is always refreshing to see and hear the problems of treasury management from a different perspective or operating environment. What is most gratifying after a ***talkingtreasury*** conference is to see how much treasurers are prepared to share experiences and to learn from their peers – and then work together on common problems.

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For more on the corporate response to regulatory proposals for derivatives, go to: **http://bit.ly/cR4AGH**