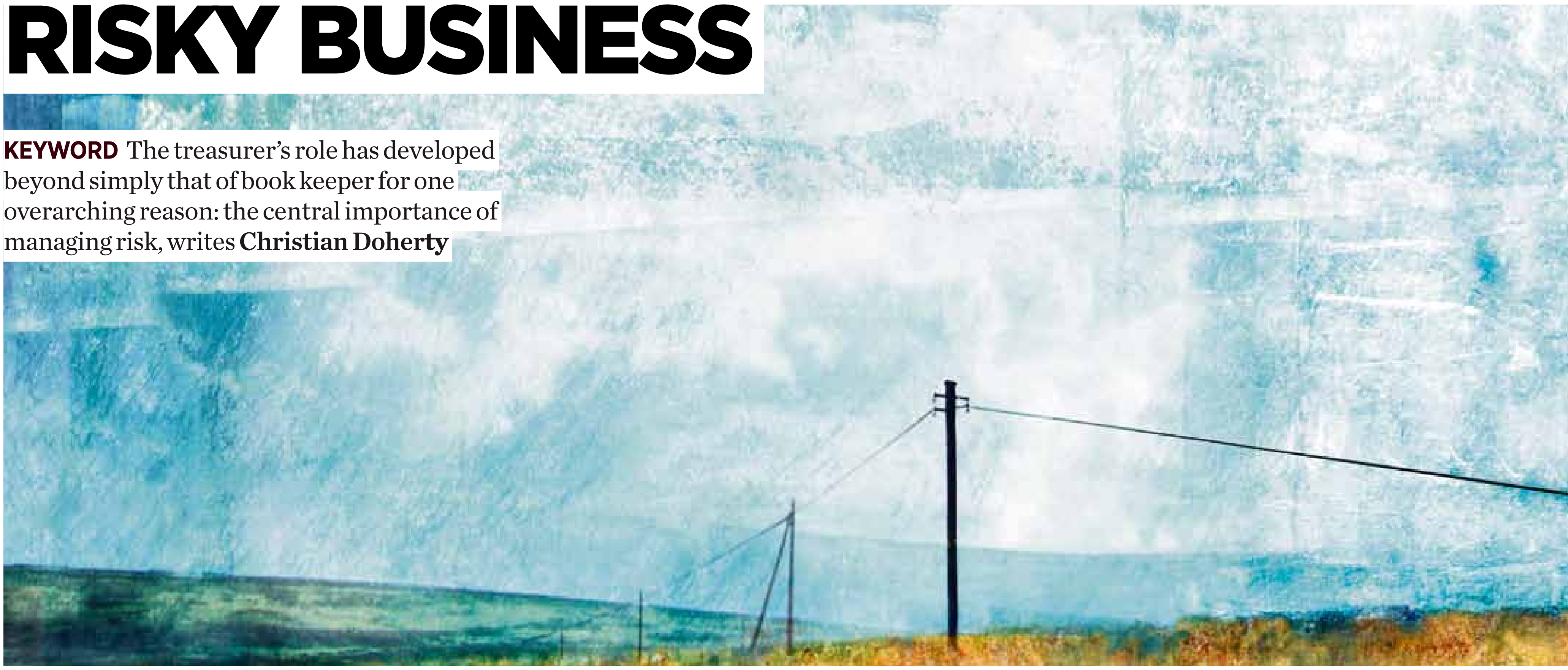
RISKY BUSINESS



KEYWORD The treasurer's role has developed beyond simply that of book keeper for one overarching reason: the central importance of managing risk, writes **Christian Doherty**

Since the crises of 2007-09, corporate treasurers have needed to focus much more closely on business risks, many of which were previously tolerated or ignored. From simple cash pooling to ensure efficient warehousing of funds at days' end, corporate treasurers are now expected to adopt a real time risk management strategy that encompasses all areas of concern.

The only certainty in today's financial environment is that conditions remain volatile, and the future uncertain. In treasury operations, arguably the highest priority is ensuring that the business has sufficient cash to funds its needs. Ultimately, in an environment of unprecedented risk, only sensible treasury management can support sustained commercial operations.

And for many treasurers the focus has shifted from simply assessing yield to managing risk on an ongoing basis. Kevin Grant is CEO of IT2 Treasury Solutions. In his view, the treasurer can play a central role in protecting the company from the full suite of risks.

"Counterparty risk is a front line risk management topic for corporate treasurers, both for risk analysis and for assigning dealing limits," he says. "The financial crisis proved that classical credit ratings are too slow moving to provide an effective solution for volatile credit environments. Today, more and more treasurers are monitoring counterparties' creditworthiness using market sensitive, fast moving indicators such as Credit Default Swap spreads, equity and bond prices and probability of default factors. Such measures cannot eliminate uncertainty – but they can help treasurers to navigate it more effectively."

Adopting a more fleet-of-foot approach does demand more of the treasurer who effectively becomes the first line of defence against the range of risks inherent to a broad treasury strategy. Indeed, in uncertain economic times like attention turns to the timeliness and accuracy of account information.

"Corporates require real- or near real-time views of their liquidity and it is no longer acceptable or useful to rely on end-of-day updates," says Grant. "Account management must be flexible and more automated, for example, the automating of setting target balances and sweeping funds into different accounts to take advantage of interest rate differences."

Alongside the principle of security, ensuring ease of access has always been a key priority for most businesses. Indeed, the average corporate board is accepting to a degree that the cost of carry is a necessary price for maintaining robust liquidity and the right funding position.

Liquidity is, was and always will be crucial to any business, so raising those funds and that liquidity when you need it, of course, is very, very important to any treasury strategy. The key risk in that context then sits in securing long term non-bank funding in order to mitigate a business's refinancing risk. Liquidity risk is now at the top of many treasurers' priorities.

Guillemette Colrat is treasurer at French food service company Elior (see box out). She makes sure her

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CASE STUDY

Elior may not be the most familiar name, but a look at the brands it owns or operates franchises of should give a clearer illustration of the influence of this French giant: Paul, Costa Coffee, Illy, Subway, Pieminister, Coffee Nation, Lock Fyne, Digby Trout, Holy Crepe and Lovejuice, to name but a few.

Based in France, Elior is now one of the major operators in contract catering in Europe.

Guilemette Colrat has been running the group's treasury operations since 2000. In that time she has seen sales increase to €4 billion as the company has expanded its operations into in the UK, Holland, Italy, Spain, and even to some outposts of South America.

It's her job to make sure risk is identified and managed – not easy when the business is so disparate and complex. Her solution has been to centralise treasury operations.

It's an area that Colrat has worked hard to bring under one roof. After all, the more disparate treasury becomes, the less effective controls tend to be. "The expertise needed for financing activities and management of liquidity risks is quite difficult to deal with both in terms of know-how and human resources," she says.

"Therefore we believe risks are better monitored when centralised within the hands of skilled pilots, with unique operating guidelines and processes". In addition, the centralised scheme also allows Colrat complete visibility over the group's cash position.

And that, she explains, is crucially important in the current environment of greater board and shareholder interest in corporate exposure to a growing spectrum of risks. Stakeholders are now far more tuned into where the company sits in its intra-day position, while cash pooling and reconciliation strategies are of greater interest to all parties.

"What has been very important and what is still very important for us is to demonstrate the level of control over cash," she explains. "We are obliged to more reporting activities to management and shareholders, especially in terms of risk and liquidity management."

team stay on top evaluating the strength of Elior's investments from a liquidity perspective.

"I want to know what the asset managers do when they invest the liquidity and if they take any risks, for example, and to ask whether there are any risks in those collective investments," she says.

So how does that take shape? "I just need to get into that to see what they're doing, to be sure that we are not exposed to any risks on our investments and to make sure they're always IRS7 compatible," says Colrat.

The banking landscape will therefore be of enormous interest to treasurers looking out at the next few years, who will need to answer the question of how the change in capital markets and the relationship between banks and corporate will alter their perspective to long term funding (see box).

At the same time, treasurers must answer the questions posed by other risks. For larger businesses, the time-bomb that's been ticking for a decade is pension risk. Anyone unconvinced of the scale of problem should consider the recent findings of a survey conducted by the Institute of Chartered Accountants in Scotland (ICAS). The survey found an aggregate deficit for the FTSE 100 defined benefit pension schemes (DBPSs) of £53.5 billion, made up of liabilities of £409.8 billion offset by assets of £356.3 billion.

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And despite the commitment from leading companies to disclose how they are managing their pension risk, the ICAS figures revealed that only ten companies disclosed the sensitivity of the DBPS's liabilities to all four actuarial assumptions, as recommended in the UK Accounting Standard Board's suggested guidelines on best practice (2007).

But for those who are tackling this, there are a number of key risks to take into account. Movements in interest rates will feed into factors such as equity prices, price inflation and salary growth. All of these can materially affect the funding position of a business's pension liabilities, so the treasurer is faced with the tricky task of maintaining an adequate funding strategy without adversely affecting the companies cashflow and trading operations.

But while pensions are a long-term risk that demands a long-term approach, the immediate risks inherent in volatility currency markets also pose a challenge. "It is vital for companies relying on international trade to use FX trading to protect themselves against potential risks to their cash flow, profits and corporate value," says Mark Warms, general manager, EMEA, FXall. "They need to be savvy about the impact that political and financial events can have as well as force majeure.

"FX risk managers need to have timely access to accurate data, quantifying exposures and achieving accurate analysis of risks so that they can hedge effectively. Corporates now have a greater reliance on their treasury management system to consolidate these factors and help manage FX risk in line with stated policy."

Kevin Grant at IT2 agrees. "Corporates face pressures in the FX markets due to liquidity and counterparty risk considerations, which lead to inferior quotations and wider spreads. Technology can help by integrating the treasury management system with FX trading portals to optimize the speed of locating the best available price in the market and executing the deal with a permitted counterparty."

So how can the treasurer mitigate that risk? "Technology cannot eliminate volatility or credit collapses; but it can help treasurers to navigate uncertainty with increased confidence and effectiveness," is Grant's view. And it's true, the suite of products available do strengthen the treasurer's hand. But that on its own won't be enough.

THE BANKS: PROBLEM OR SOLUTION?

In the wake of the banking crisis, regulators across the world have reached agreement that banks must hold more capital against their assets. At the vanguard of the effort to ensure this happens, the new Basel III proposals increase the general requirements firstly by defining Core Tier 1 capital more strictly. The second prong of the attack comes by increasing the per centage of capital to be held against risk weighted assets (RWAs) and thirdly by changing the RWA calculations for certain asset types it considers very risky.

What does this mean for treasurers? Many things, principally that uncollateralised OTC derivatives have been identified as risk-weighted assets and as such a more penal additional asset weight is being proposed. The standard formula for calculation of this additional charge is most sensitive to the credit quality of the counterparty and the current fair value of the exposure to the bank (i.e. where the corporate owes the bank).

However, there's no question that the banks are preparing to pass on the cost of increased capital requirements to their customers, presenting treasurers with another risk to mitigate.