{ WHAT A FINE MESS }

TRAVIS BARKER

GUEST COLUMN It's unfair that corporate treasurers are paying the price for excess bank lending and inadequate regulatory and monetary oversight

Financial markets continue to be convulsed by the deepest and most pervasive crisis since the Great Depression. The crisis is complex and has many underlying causes: cheap credit and lax lending standards; off-balance financing of mis-priced assets; weak regulatory and monetary oversight; conflicting post-crisis macro-economic policy objectives; and so on. The crisis has provoked equally complex responses that are likely to interact in unpredictable ways, with unintended consequences. Take, for example, the possible consequences of two aspects of bank reform for corporate treasurers.

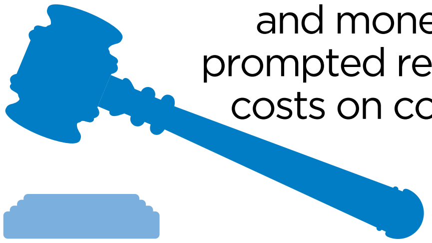
Bail-in: mixed messages on credit risk

Taxpayers ought not to be burdened with the cost of bank bailouts. Therefore, among other suggestions, the EU has proposed a 'bail-in' regime. Bail-in enables regulators to transfer part of the cost of a bank rescue to its investors. The type of instruments that will be bail-inable is still unclear, but seems likely to include very short-dated liabilities, including those used by corporate treasurers to manage working capital.

Bail-in reinforces the fact that corporate treasurers face credit risk when they deposit with banks. The obvious response is to perform more careful credit analysis of a diversified panel of bank counterparties. This has led many corporate treasurers to increase their use of money market funds (MMFs), which are designed to provide precisely those benefits.

But, in another context, bank regulators are pursuing reforms that will seriously compromise MMFs. In particular, Paul Volcker, former chairman of the Federal Reserve, and Paul Tucker, current deputy governor for financial stability at the Bank of England, are lobbying for changes to the way that MMFs price their assets, which would render them much less attractive to most corporate treasurers.

> It is deeply unsatisfactory that a crisis that arose because of excess lending and inadequate regulatory and monetary oversight has prompted reforms that impose costs on corporate treasurers



Regulators are providing mixed messages. On the one hand they are insisting that corporate treasurers face up to credit risk; but, on the other hand, they are denying corporate treasurers the very tools they need to manage that risk.

Liquidity coverage ratio: incentivising risk taking

The revised Basel Accord imposes a liquidity coverage ratio (LCR) on banks. The LCR is intended to ensure that a bank maintains enough cash to meet its 'net outflows' for a 30-day time horizon under an acute stress scenario. For those purposes, deposits by corporate treasurers are deemed particularly prone to outflow and therefore worsen a bank's LCR. Banks will have to price in that regulatory cost by offering lower rates to corporate deposits.

But, in their efforts to strengthen the balance sheets of banks and restore credibility to bank regulation, these reforms are merely passing risk from the financial system into the real economy. If future deposits interest rates remain lower than inflation, which seems likely, then institutional investors face a future in which they are exposed to negative real interest rates, ie the gradual erosion of the principal value of their cash. One can imagine them responding in either of these ways:

- Companies may try to manage their operations with minimal cash balances, in order to avoid the cost of carry and notwithstanding the potential liquidity risks; or
- Companies may creep out along the yield curve in the search for yield, and notwithstanding the potential liquidity and credit risks.

Either outcome would represent an increase in risk taking, ie the LCR would have reduced risk in the banking system, but incentivised greater risk taking in the real economy.

It is deeply unsatisfactory that a crisis that arose because of excess lending and inadequate regulatory and monetary oversight has prompted reforms that impose costs on corporate treasurers. It is essential that treasurers work with relevant trade associations (most obviously the ACT, the European Association of Corporate Treasurers and the Institutional Money Market Funds Association) to challenge these reforms, particularly by raising awareness among finance ministries of the likely unintended consequences of agendas being pursued by central banks.

Travis Barker was chair of the Institutional Money Market Funds Association from March 2009 to June 2012. He is writing here in a personal capacity