

# Latin roots prove contagious

Spain's nascent risk management community has been rocked by mounting credit risk exposures from Brazil and Argentina. Spanish GARP members say that long-time business links between Spain and its Latin American counterparts are causing headaches for exporters. More are beginning to ask themselves when is translation risk going to turn into default risk?

**W**eighed down by deteriorating investments in Brazil and Argentina, Telefonica, BBVA, BSCH, Repsol-YPF, Endesa and many other Spanish companies have reported painful losses in their recent financial statements and disclosures.

“A number of Spanish companies have big business interests in Argentina which have been lucrative for them in the past. At the moment, a lower level of business activity is what they are mainly concerned about, particularly since funds currently cannot be transferred from Argentina,” explains Jose Manuel Aguirre, a commercial director at Aplicaciones de Inteligencia Artificial in Barcelona.

The Telefonica Group, Spain's largest telecommunications company, was one of the first this summer to reveal the hits it had taken from currency devaluations in Argentina and Brazil. By mid-July its operating revenues for its Latin America group had dropped 23.3% on the year, and it attributed the Argentine peso's 73.7% devaluation against the US dollar as one of the main reasons.

Local sources attest that a number of Spanish exporters, many from the industrial production sector, have been increasing their use of short-term forward exchange contracts and other plain vanilla derivatives to help them mitigate foreign exchange translation risks. Credit insurance and counterparty and default risk analytics have also become popular

themes in Spain's corporate risk management community this year.

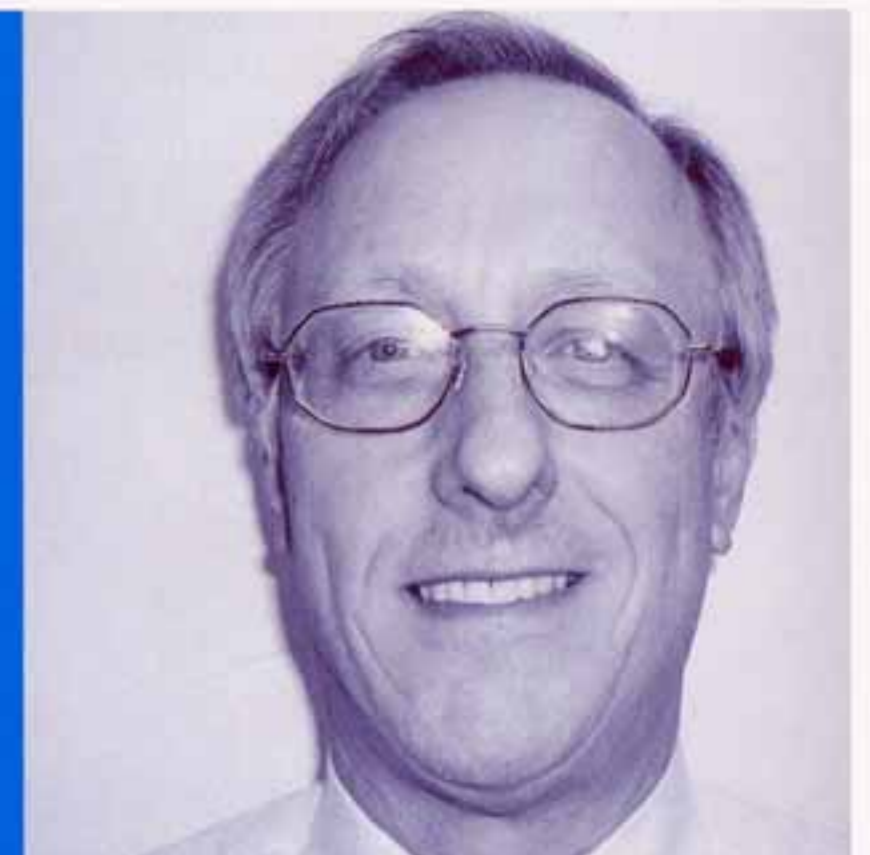
“There is not a size or maturity length that is typical of the foreign exchange options. It basically depends on when an exporter expects to collect or when an importer has to pay, but they are all pretty much accustomed to choosing the most economical mechanism for covering their currency exposures whether it is a forward contract or not,” he notes.

Even so, sources admit that alternative measures for managing risk are still hard to come by in Spain's sprouting risk culture and that few corporate treasurers are using the currency devaluations in Latin America as warning signs for further losses due to default risks. Although credit risk management has improved in the post-peseta market, they say few exporters have moved beyond traditional products, such as guarantees, bank references or export credit insurance from Credito y Caucion, Compania Espanola de Seguros de Credito a la Exportacion (CESCE), Euler and Coface.

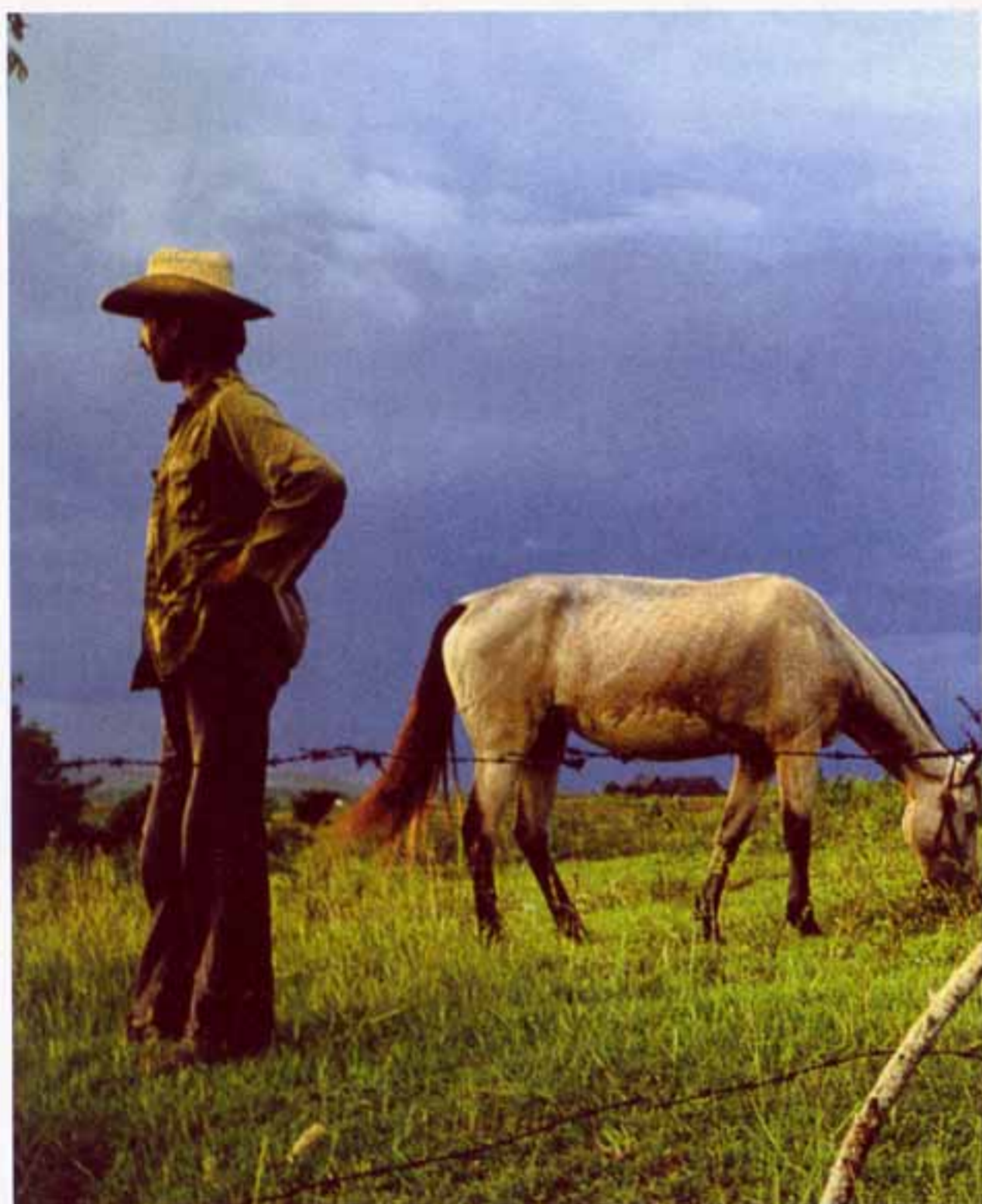
Josep Monclus, finance director for Fujifilm Espana and president of Asociacion Espanola de Financieros y Tesoreros de Empresa (ASSET), Spain's corporate treasury association, says that risk management is still more of a cash management function.

“Even some of the multinationals have not created executive risk management posts yet. This function typically falls

**Monclus: Spain's options market is minute**



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under the cash and treasury management, so most corporate risk management techniques involve cash flow analysis and integration. The idea is to manage liquidity better and make sure that it is flowing as efficiently and securely as possible.”

He adds that the options markets are very small from a corporate perspective in Spain and that companies have been less worried about foreign exchange risk since the euro was introduced. “Debt and liabilities are mainly in euro, but some firms have yen and dollar exposures. If they are large enough, then they can use swaps.”

David Murano, head of risk management for the financial markets division at Bank Pyme in Barcelona explains further: “Our corporate clients have definitely become much more concerned about credit risks over the past two years. There has been a significant increase in the number of Creditos documentarios and a huge increase of Remises Documentarias. Documentary credit is by far the main system used by Spanish exporters to hedge their exposures, and it is offered by most of the domestic commercial banks. A couple of years ago, it was used only in the first stages of a trade relationship but

nowadays it is a must. But I have to say that corporate clients still neglect to hedge any of their credit or foreign exchange exposures.”

Some Spanish companies are now setting up credit departments for letters of credit and collections, for example. However, it cannot be said that it is in direct relation to worsening Latin American exposures.

“We have not seen any companies securitise receivables or do any kind of public structured finance deals for trade-related credit risk. Spain is in the early stages of the risk transfer market, and most exporters are just looking for soft loans. Some companies are also doing things like confirming and factoring, but few are engaging in alternative risk transfer yet,” adds Juan de la Mota, managing director for Standard & Poor’s in Spain.

Kevin Kime, a director in Standard & Poor’s international structured finance group adds: “The Argentina crisis is bound to get exporters interested in things like transfer and convertibility risk insurance, which protects foreign lenders from the imposition of certain foreign exchange controls in emerging markets, as well as future flows. In future flows, the exporter sells the production that it will generate in the future. The payments come from offshore and then go into an offshore account to protect the investors. This structure is used all over the world for lenders and exporters who want to reduce payment and interference risks. The problem for foreign lenders in Argentina is that not many were done because of convertibility controls on the peso.”

International players say that education is still paramount in Spain, particularly on the corporate side. The problem, as one risk consultant in Barcelona points out, is that companies need to understand and identify their counterparty risks better.

“Larger Spanish companies have internal IT platforms that can keep better track of financial data. Some even have alert systems to help them look at credit behaviour. Companies with lots of varied counterparties are also installing credit-scoring systems. But they really need to learn how to use this data to help them analyse the risks and, indeed, try to predict them better,” says one risk consultant.

Monclus adds: “As our membership increases, we are seeing a growing awareness of risk management. I think that crises like what is happening in Latin America is making some of the larger companies realise the competitive advantage that good risk management gives them.” ■