Time for more sophisticated corporate investment strategies

The current difficult market environment raises the bar for investment strategies of corporate treasurers. Clearstream's Otto Vaisanen explains how innovative collateral re-use opens up a whole world of opportunities for corporate treasurers in line with upcoming regulations.

The consequences of new regulation in financial markets have been well documented. Since 2008, financial institutions are required to reduce leverage, make more effective use of capital, optimise their balance sheet and diversify their sources of liquidity in the interest of making financial markets safer and more stable. But is this environment also safer for corporate treasurers?

Arguably, the answer is yes although the environment has become much more challenging. As a result, corporate treasurers need to look into more innovative cash placements as part of an overall push towards more sophisticated investment strategies in the corporate world.

One of the big challenges is that banks are awash with cash which makes time deposits, in particular short-term cash placements, unattractive as they increase the cost and volatility of balance sheets. In addition, new guidelines on money market funds and the introduction of variable net asset value means that liquidity funds could potentially lose value in times of market stress.

As a result, there is an increased risk that the reinvested cash may not be fully returned in all cases. The additional complexity of the current negative interest rate environment in the Eurozone further strengthens the traditional mantra of the corporate treasurer that "security of re-investment comes first, then liquidity, then yield".

Triparty repo as an attractive investment opportunity

This is why triparty repo has entered the arena as new re-investment opportunity. And it is easy to see why. Unlike time deposits, triparty repos are backed with specific collateral which fully secures the re-invested cash. In addition, the collateral is marked to market on a daily basis by a triparty collateral management agent such as Clearstream. A triparty agent is a neutral third-party that focuses on asset safety and specialises in wholesale custody and settlement services. The collateral it holds for its customers is completely ring-fenced.

A further advantage of triparty repo is that when a corporate treasurer receives collateral under a repo, it can be re-used to support other financial transactions the treasurer engages in. This presents a genuine commercial advantage. In addition to offsetting the potential risk of an insolvency of the repo counterparty, collateral received under a repo is transferred with full title. It is therefore effectively owned by the corporate treasurer pending the closing of the repo (at which point the cash will be simultaneously returned to the treasurer and the collateral to the counterparty).

This not only meets the security element that is essential to corporate treasury strategies but also offers genuine liquidity and yield alternatives. Since the triparty agent insources the operational management or back-office of any collateral movements or margin calls required on

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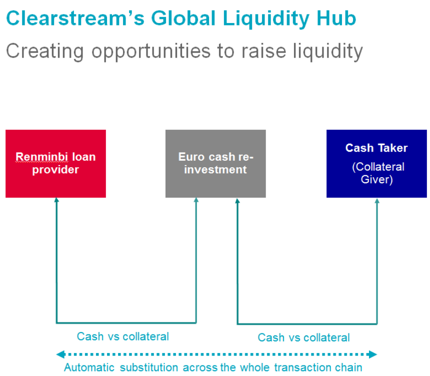
Multiple collateral re-use possibilities

Let's look at what a corporate treasurer could actually re-use collateral for. It can be used for pretty much anything as long as the collateral is ring-fenced under the watchful eye of the triparty collateral manager to guarantee asset safety and protect the interests of both the corporate treasurer as collateral receiver (securing his investment) as well as the financial institution as collateral giver (facilitating portfolio movements and substitution rights).

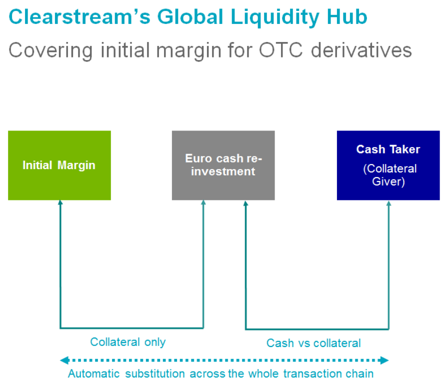
A first re-use opportunity is the raising of liquidity. For example, imagine a treasurer with excess euros to re-invest who is looking to raise Chinese renminbi as part of a separate transaction to support onshore manufacturing operations. The collateral received under the euro triparty reverse repo from one financial institution can be mobilised and re-used with ease by lodging it with another financial institution that can lend renminbi. This does not entail additional operational overhead on the part of the treasurer.

DIAGRAM 1
RE-USING COLLATERAL TO RAISE LIQUIDITY



A second collateral re-use opportunity is the covering of margin calls related to OTC derivative transactions.

DIAGRAM 2
RE-USING COLLATERAL TO COVER INITIAL MARGIN OBLIGATIONS



Under new EMIR requirements, a number of counterparties that trade swap transactions will now need to post assets to clearing houses to offset the risks associated with these products. The amount that needs to be covered is more commonly known in financial markets as initial margin and can usually be covered with either cash or eligible securities. However, in view of the current negative interest rate environment in the Eurozone, it is becoming more commonplace for clearing houses and their members to prefer the use of securities as collateral where feasible.

For corporate treasurers who don't own or manage a portfolio of bonds to lodge as collateral, triparty repo presents a simple solution to access securities. For example, a corporate treasurer could re-invest some of its euro balances for term and then simply re-use the collateral it receives to cover its initial margin obligations. This same example also applies to variation margin under the credit support annex (CSA). Instead of the corporate treasurer posting cash collateral to a bank to cover its margin obligation and potentially paying a negative rate, the treasurer could simply replace the cash with bonds or equities as collateral. To do this, the corporate treasurer needs to withdraw the cash posted as collateral and instead invest it in a term reverse repo and then reuse the received collateral to cover its margining obligations.

It should be noted that EMIR also allows certain money market funds to be lodged as collateral with clearing houses. Therefore, corporate treasurers not only have the opportunity to re-use collateral received from repos to cover margin obligations, they could also use direct money market fund investments as collateral via triparty agents such as Clearstream without having to redeem them.

In sum, triparty repo and the resulting re-use opportunities for the received collateral offer corporate treasuries additional flexibility and a wider range of product options in terms of accessing and investing liquidity. In addition, triparty repos are very cost-efficient, making them a very attractive way for corporate treasurers to make their investment strategies more sophisticated in a simple manner. For the corporate treasurer, triparty repo and the re-use of collateral certainly appear to be raising the bar and open the door to new investment opportunities in the current changing regulatory environment.

Clearstream
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Prior to that, he worked as a GSF sales manager for six years during which he was responsible for the French, Spanish, Belgian, Luxembourgish, Finnish, Turkish and Swiss markets. Otto joined Clearstream in 2005 in GSF operations.