

Ongoing debt problems in Greece and other European nations are a constant reminder that risk has not gone away, and this market uncertainty is motivating prudent corporate treasurers to hang on to their cash.

The overall liquidity pool in the corporate sector right now is very deep. Gross cash and cash equivalents held by 672 companies in Europe, the Middle East and Africa rated by Moody's, amounted to \$1.06 trillion at the end of 2014, according to a *Financial Times* report in July. And with some banks even charging corporate clients for depositing cash, investing securely while gaining some additional spread is becoming increasingly challenging.

Oil is one sector that traditionally sees large cash concentration. At the end of Q1 2015, the Shell Group reported balance-sheet cash of \$20bn, with a cash flow from operating activities of \$7.1bn. It's no wonder, then, that Shell has a diverse cash-investment portfolio that takes advantage of centralising its cash in London with the support of regional centres in Singapore and Rio de Janeiro.

One important and well-used product in Shell's cash investment suite has been tri-party repurchase agreements (repos), reports Frances Hinden, VP of treasury operations at Shell International.

Shell signed its first tri-party repo agreement in 1997, but it only began using the tool seriously around 10 years ago, after a new front-office recruit from the Bank of England asked why the company was not investing in repos. Back then, many processes were still manual and concerns about operational risk prevented Shell from investing much in repos.

#### A new master agreement

"We didn't do much back then, but we did set it all up," says Hinden. "We had to agree GMRAs [global master repurchase agreements] with each counterparty individually, and there are still scars on some of our legal team because one of the GMRAs took five years to complete."

The GMRA has been the industry-standard international contract for more than two decades and it has to be agreed bilaterally between each pair of counterparties. But horror stories, as experienced by Shell, have earned it the reputation for being sometimes difficult and expensive to negotiate.

Seeing that this was becoming a barrier to entry for some corporate treasurers led Clearstream to develop an easy-access, standardised master agreement – the Clearstream Repurchase Conditions (CRC) – to help its clients to enter the tri-party repo market. Unlike the bilateral GMRA, the CRC is multilateral, so a repo participant only has to sign one document and is then able to trade with any other counterparties within the CRC community.

"My advice to other treasurers is not to do what we did and enter into a GMRA, but to use

the standardised CRC with everyone," says Hinden. "The really painful part of this was negotiating the GMRA and, if you can avoid that, then it would make the whole set-up so much simpler."

Having endured the pain means that Shell now has what Hinden calls a "bullet-proof GMRA", and tried-and-tested collateral eligibility criteria that are implemented with every new banking counterparty.



# Bring on the basket

HOW DOES SHELL MAXIMISE THE POTENTIAL OF COLLATERAL THROUGH TRI-PARTY REPOS? CHARLIE BEDFORD-FORDE EXPLAINS



## A simpler approach

The Shell treasury team collaborated closely with Clearstream and Bloomberg to overcome the operational risks intrinsic to largely manual processes.

“We said what we would like to see and then Bloomberg set up new functionality and Clearstream set up the connectivity to the functionality,” explains Hinden. “And that means we now have a much simpler approach: there’s an online quote facility and we agree everything with the counterparty online via Instant Bloomberg (a chat tool).

“Typically, we agree one to two days before the investment and they confirm. The deal is then processed automatically straight through from Bloomberg to Clearstream. The only thing our team has to do separately is move the cash.”

This high level of automation and the fact that the administration, collateral allocation, substitution and margin management is carried out by a tri-party agent (Clearstream) has encouraged Shell to use repos as a regular part of its investment strategy. In particular, Hinden is happy that Shell has an agreed basket of acceptable collateral in return for the cash.

“It is a very simple statement that says: ‘This is what we accept. This is what the haircuts are’,” she explains. “Then we ask the banks to quote on the basis of our basket.”

Shell usually invests in repos from seven up to 90 days, while its overnight liquidity is still mainly in money market funds (MMFs). In accordance with its risk policy, the Shell treasury team chooses to accept only high-quality securities as collateral. This makes the repo very safe and yet still able to pick up a reasonable yield.

## COLLATERAL DOUBLE DIP

Shell has recently extended its repo strategy – it now reuses the securities received as collateral in fulfilment of exchange margin requirements for commodity trades.

“This is a way to get a ‘double dip’ on those securities,” explains Frances Hinden, VP of treasury operations at Shell International. “In Shell’s treasury, we have spare cash, while our colleagues who do commodity trading have margin requirements at the trading exchanges that they can satisfy using high-quality collateral or cash. They cannot get a return on the cash – and, in fact, they are even charged for depositing it.

“So the Shell Group is much better off if we use our cash at the bank in a repo, receive the collateral and return on that cash, and then use that collateral to satisfy margin requirements.”

Formalising the transfer arrangements, and solving legal and risk concerns between treasury, the exchange and separate Shell trading companies took time to set up.

“The idea of this was simple, but the implementation took a good year of legal discussions,” says Hinden. “But eventually everyone signed up and now we are live.”

With this strategy, Shell is well prepared for the new regulations that push all derivative trades through clearing houses, thereby increasing margin requirements.

“Cash positions will be more volatile when derivative agreements are collateralised, as we will have to satisfy both initial and variation margin,” says Hinden. “So we will need to keep short-term cash and we will continue to invest in repos.”

**For an interview with Ian Chisholm, VP financial markets at Shell, see page 22**

## What’s not to like?

“It is common in the market to get higher yields on repos than on straight bank deposits and MMFs,” says Hinden. “But, of course, getting a higher yield with less risk is not logical from a theoretical point of view.”

Confounding the normal risk-return curve was down to regulatory arbitrage, she explains. “The banks have high-quality liquid assets and they need to make use of them, while still maintaining a certain level of those securities in order to fulfil their capital requirements. Repos make sense for banks, as they actually don’t like taking short-term deposits because that penalises them in terms of the amount of capital they have to hold.”

Effectively, the upshot of this regulatory arbitrage is that buy-side institutions investing in repos gain increased yields and security.

“What’s not to like?” asks Hinden.

At the moment, Shell’s treasury has a large amount of cash on its balance sheet. This is partly the result of a recent debt issuance.

“In the short term, we have a large cash position we need to manage, and tri-party repo is certainly a very good and secure use of our cash,” says Hinden.

“One challenge we face is that a number of banks have been downgraded, making it harder to find a good home for the cash in line with our counterparty limits. Repos help in this situation.”



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