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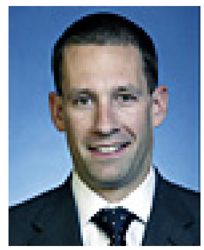
The Growing Importance of Risk Management

By
Andrew P. Reid
Director, Head of Trade &
Cash Solutions EMEA
andrew.p.reid@db.com



And
Paul Anderson
Managing Director,
Client Risk Metrics
paul.anderson@db.com

Corporate treasurers have long been responsible for risk management, but the combination of ongoing liquidity constraints and increasingly stringent compliance initiatives means that risk management has evolved from a concern to a top priority. This is particularly the case now that the link between risk management and liquidity is stronger than ever before.

While risk and liquidity have always been connected, the crisis has proved that the stability of even the strongest of companies is threatened by the mismanagement of cash. A company may have adequate funds at its disposal but, if these funds are not in the right place at the right time, a business can be brought to its knees.

There are many threats to optimal liquidity management. Operational risk is perhaps the most obvious example and the natural disasters and socio-political upheaval of 2011 — such as the Japanese tsunami and the Arab spring — mean that so-called "event risk" also springs to mind.

What may not be so obvious, or easily understood, are credit risk concerns. Pre-crisis, many treasurers only took interest rates into consideration when deciding where to place surplus cash, with return taking precedence over risk. This approach no longer suffices. As corporate cash balances are becoming an increasingly important way for corporates to fund their activities, treasurers must also factor in the banks' credit risk when placing cash.

Understanding Liquidity and Risk

Getting to grips with the changing relationship between liquidity and credit risk is not an easy task. Regulatory change, for example, is creating an additional layer of complexity by affecting the pricing and availability of bank funding.

As new capital regimes come into play, some corporates may find some of their relationship banks withdrawing certain products, increasing pricing, insisting that funds be placed for a set time-frame or demanding additional business. These are demands that corporate treasurers will need to know how best to manage — not least because of the changing relationship dynamics between banks and customers, which may compromise access to the products and services corporates require.

Understanding market indicators, such as EURIBOR (Euro Interbank Offered Rate) and the EONIA (Euro Overnight Index Average) swap is also a key issue for treasurers, as it is a reflection of how much stress there is in the financial system, and how willing banks are to lend to each other. For treasurers looking to place cash for a fixed term — three months, for example — the difference between the three-month EURIBOR and the three-month EONIA swap is crucial and could lead to cost savings and increased credit risk mitigation.

In an ideal world, the EURIBOR and EONIA swap rates would be very similar, as putting money on deposit for three months at an agreed rate is the same — in economic terms — as putting the money on overnight deposit, but rolling every night for three months with the interest rates hedged via the EONIA swap.

Yet in practice, there is a major benefit to opting for an overnight deposit rolled daily — beyond convenience — for treasurers potentially requiring access to the surplus funds: There would be no break costs in this instance, unlike cash on term deposit. Putting cash on a three-month term deposit, therefore, is effectively the same as taking three-month credit risk on a bank, and this is not a decision that treasurers should take lightly.

Technology Tools

Also, treasurers are increasingly recognising that advanced technology can come to their aid with respect to analysing risk throughout the entire value chain. While a siloed approach to risk management allows for the formulation of contingency plans for individual events, it is tactical rather than strategic in nature, and fails to address risk at an enterprise-wide level. As treasury departments are now strategic divisions rather than processing units, they need tools that allow them to best manage their position as the vital link between their organisation's different business areas.

In order to do this, treasurers need solutions that provide greater visibility and transparency over real-time information. Treasurers are under pressure to produce results in increasingly tight time-frames, which makes access to real-time and relevant information — across banks and currency and exposure levels — crucial.

In recognition of this, Deutsche Bank has developed *Autobahn*, the result of a merging of systems, platforms and expertise across the Bank's global markets operation and transaction banking units. *Autobahn* is an award-winning electronic distribution service that acts as a single gateway to the Bank's powerful analytics and published material, and allows treasurers to view a consolidated liquidity position across regions, currencies and banking relationships. As a result, they can enhance risk mitigation and maximise investment returns through increased transparency.

The Importance of Communication

Yet technology, regardless of its sophistication, does not independently constitute a solution in these complex times. Banks are increasingly asked for consultation and guidance and, as a result, Deutsche Bank is working to better understand industry and regulatory developments to assess where and how it can truly add value for its clients.

Deutsche Bank also recognises the importance and value of communication. The Bank works to promote increased communication between banks and treasury departments, as well as greater collaboration and communication throughout the treasury management industry as a whole. At Deutsche Bank, we believe that dialogue and cooperation, when leveraged by technology, are the keys to the future success of this rapidly evolving sector.