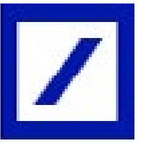

TreasuryPulse

# Re-evaluating Your Company's Bank Counterparty Risk

By
Martin Runow
Americas Head of Cash Management Corporates
martin.runow@db.com

And
Dirk Schumann
Americas Head of GTB Asset & Liability Management and Structured Liquidity Products
dirk.schumann@db.com

The expiration of the Federal Deposit Insurance Corporation's (FDIC) unlimited insurance for non-interest bearing transaction accounts at the end of last year prompted treasurers to re-evaluate their US bank counterparty risk.

The FDIC's Transaction Account Guarantee (TAG) program was instituted in reaction to the financial crisis. Lehman Brothers shocked the global financial community by filing for bankruptcy in September 2008, leaving clients scrambling to recover assets held at the Wall Street firm. Although panic from that period has subsided, the memory should remain etched in treasurers' risk-management playbooks as they look for banks to manage their corporations' payments and serve as a safe haven for liquidity.

## Risk Tolerance and Diversification

Every company must establish its risk tolerance relative to bank deposits: What amount is it willing to risk losing access to — either temporarily during a period of stress or permanently? That determination will depend on the geographic footprint of the company's operations as well as the concentration of those deposits in different currencies — i.e., does the company hold deposits in a few key currencies, or does it have a diversified currency basket?

Once the company's risk tolerance is set, the financial strength of those banks that handle critical currencies for the company needs to be assessed. A key component of this analysis

involves reviewing the ratings from external agencies. Credit-default swap spreads are another common tool assisting this evaluation, along with various metrics that many large companies with sophisticated risk management departments have developed on their own.

This can become a fairly large operation, especially when a company decides to spread the liquidity over many banks by way of diversification as a risk mitigant. On the other hand, many large corporates have chosen to limit their banking networks to a few large global banks, which allows extensive research into the financial position of those critical institutions, as well as stronger banking relationships.

## Establishing Your Global Cash Positioning

Either way, once risk limits are set, the next step in managing bank counterparty risk is to determine just where the company's cash is among those banks, as efficiently as possible, now and in the near term.

Many companies still pull their cash positions from their banks' websites and manually record them in spreadsheets once a day. Such an approach, however, is inefficient, prone to error and likely to leave boards of directors overseeing a company's risk management policies less than impressed. The process becomes dramatically more complex for global companies that operate in different locations and currencies and across multiple bank relationships around the world.

Some large banks as well as independent vendors offer systems to automate that process, allowing corporates to see throughout the day a snapshot of their cash balances by geography, currency, banking institution and other criteria. For example, Deutsche Bank's Liquidity Manager tool, available on the Autobahn App Market, does just that, while also providing planning capabilities to note when payments are expected to arrive or be made. The treasurer and risk managers can use this information to forecast when a company will have an elevated cash position with a specific financial institution. It will also allow them to monitor and act upon actual counterparty exposures in line with a company's risk tolerance and policies.

## Act Upon Cash Flow Plan

Corporations also need to evaluate the automated tools available to minimize unnecessary risk exposures. For example, four subsidiaries of a company may work with the same bank, three with $100 million credit balances each and one with a $100 million debit balance. In such a case today, the company earns virtually no interest on the $300 million in credits and has to pay interest on the debit. Furthermore, the company has an overnight exposure of $300 million to a single counterparty.

By asking the bank to set up a debit/credit zero-balancing cash pool structure, the four account balances would be consolidated before the end of the day, netting the company's exposure to that financial institution down to $200 million while avoiding debit interest.

Another option would be to automatically sweep cash over a predetermined threshold into overnight investment options such as mutual funds, where the company may be able to earn a somewhat better return and, more importantly, reduce risk concentrated at banks. While a bank's transaction banking division does not act as an asset manager or advise the corporate client which funds to buy, it offers a variety of funds for the clients to choose from and allows the client to set limits on how much cash can reside in each.

In addition to this automated investment process, longer periods of excess liquidity can be withdrawn from the core relationship banks to maximize returns while also mitigating counter-party risk. Excess cash does not have to reside in a bank account. It could be invested in a mutual fund, and in the future, for Deutsche Bank clients, this can be done through the same Liquidity Manager App that is used daily to monitor and forecast cash positions.