Managing your counterparties

Charles Palmer of Richmond Software examines the way in which treasury management systems help treasurers manage their external relationships.

Modern treasury systems have become very comprehensive in their functionality. Whereas, in the past, one system might do this and another that; today, by and large, most systems do most things for most treasuries. One of the areas that they can now provide support is in helping to manage the overall relationship with the banks and other institutions with whom a treasury deals.

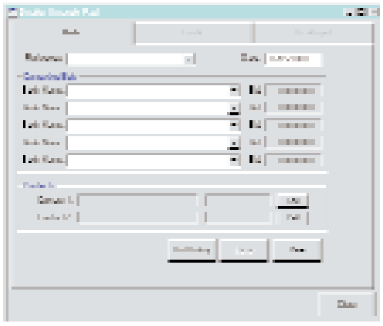
Competitive bid analysis

There are probably three main areas in which treasury systems can do this. The most obvious is in maintaining a 'competitive bid analysis'. Many years ago, when I was a derivatives dealer (last century!), I remember getting a valuable piece of business out of the blue. What happened was that our client rang us and explained that they would like to award us a new deal (probably a swap) simply because they had done some competitive bid analyses over the previous year.

We had not won once (!) but what had become clear was that we had been consistently second or third throughout. In fact we were the only bank to be so consistent and no other bank had averaged the same high level of pricing. The deal, therefore, was ours for the taking. This was very useful feedback to us as a bank because it was rare that we ever got to know how we did *vis-à-vis* our competitors.

This was very nice but what was surprising was that the corporate concerned clearly maintained a very accurate and comprehensive record of all its deals and the bids that they had received. This was all before treasury systems had even been thought of. Nowadays, most systems will do this and presumably, many more banks are at the receiving end of these sorts of calls.

To illustrate this in more depth, *Figure 1* shows a screen shot of our own system, which is the sort of thing that our competitors will do as well. This is what we call the 'Dealers Scratchpad' which is where a dealer can record all the bids (up to five) that he receives for a particular transaction. You can see a button marked 'bid history' which, based on certain selection criteria, will provide a list of who in the past has been successful (1st, 2nd and 3rd) – ie which counterparties should be on the short list.



Although it is not clear from the first tab which we show here, on the third tab the user can describe what the bid actual is – for example, on a forward foreign exchange (FX) deal the issue might be how competitive the forward points are rather than the spot rate which reflects more of a commodity price. Clearly with all of this information sitting in the database, it is very easy to get retrospective analysis.

Going back to the last century again, if these sorts of tools had been around then, the call I got 'out of the blue' really wouldn't have been out of the blue at all.

Risk equivalency

Taking this screen shot further, the second tab is marked 'Credit' and leads us onto the second area where modern systems can help in managing counterparty relationships. Given some of the 'scandals' in recent years; most corporates are sensitive to their exposure to their dealing banks. Systems can help here too. For example, the idea in the Dealer's Scratchpad is that, before dealing, it may be prudent to check the headroom available first. The key issue here is that the system has to translate a wide variety of deal types onto a 'risk equivalent' basis. Placing money on deposit may lose the principal plus outstanding interest. This is clear and simple. It is not so simple if one enters into a five year knock out interest rate cap instead.

How should the exposure be measured on this? Systems have to provide the user with a variety of rules which can embrace a wide variety of deal types. In this way, the user can bring his exposure to risk equivalency.

What is also important is that the system can also mark all of these positions to market (which most can) because the mark-to-market value may exceed the 'rule' that was established at the time the deal was done.

Managing facilities

The third key area in which systems can help is really the reverse of monitoring credit exposure – managing the facilities and credit facilities that the banks have granted to the corporate. It is important to know how much headroom is available under any facilities for managing risks like liquidity. Sometimes this headroom may fluctuate simply due to a movement in FX rates.

It is also important to keep track of fees payable on these facilities. This can be quite complex when the facility embraces drawdowns across several legal entities within a group, is multicurrency and has more than one fee structure to apply. Modern systems should take this in their stride and provide the user with the information he or she needs to manage their counterparties. ■

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