First among equals

THE WORK OF THE FINANCIAL INSTITUTION TREASURER HAS DIFFERENT FACETS, BUT CHIEF AMONG THEM IS CASH. **PETER WILLIAMS** TALKED TO DAVID STUNELL TO FIND OUT MORE.

According to David Stunell, who has worked as a treasurer for a range of financial institutions across the years, the role of a financial institution treasurer is a relatively simple affair. The biggest risk is losing yourself in the detail and overcomplicating things. Stunell, retail and wealth treasurer for RBS, says: "While it is important to capture all of the information, it is important not to spend too much time on areas that won't make much difference while ignoring those that do."

Stunell believes that most treasurers of financial institutions would describe their roles in terms of responsibility for five key and distinct areas: cashflow, liquidity, funding, capital and structural risk management.

CASHFLOW IS KING First and foremost comes the management of the bank's cashflow. Prior to the crash, anyone who worked in the core business of a bank – lending or borrowing – never thought twice about making a commitment to a customer as long as it satisfied whatever target (margin, volume, return on capital) they were aiming for. The question of whether the cash would be there to do the business never arose. On the liability side, as long as the request met the contractual terms, the client could have its money back – that was never in doubt.

Provision of cashflow services to the core business is the number one priority for a financial institution treasurer. "Before the crash most of us did it rather successfully. Balance sheets were relatively easy to structure, making sure you had the cash either through the sale of liquid assets or through the ability to access various funding markets, or a combination of both. It was easy to do because investors didn't worry about banks failing. Credit was abundant."

Stunell suggests that back then the difference between a good financial institution treasurer and an average one was delivered in price, not whether they could support the core business. "I have always considered the role of the financial institution treasurer to be quite different to that of the corporate treasurer," he says. "You don't see many people who cross the divide."

Stunell has spent his working life either in banks or building societies, with the exception of a year and a half

running the EMEA division of a major inter-dealer broker. That period brought him into close contact with corporate treasurers while drawing heavily on his expertise in financial institutions. "We had a rich seam of corporate customers for our money markets, FX and consultancy businesses."

LIQUID ASSET PORTFOLIO For the financial institution treasurer the second key discipline and adjunct to cashflow provision is managing the liquid asset portfolio in a way that fits in with the business's risk appetite, meets all the liquidity metrics and minimises the cost of holding high-quality assets. "Financial institution treasurers have influence right across the balance sheet," he says. "Pre-crash, this [the liquid asset portfolio] is where in particular the treasurer, with the acquiescence of the board, could have some influence. We're in a different and in many ways a better world now."

Hitherto, interbank cash deposits, money market securities issued by financial institutions and a mixture of corporate, financial institution and government bonds made up a typical liquid asset portfolio. Now, though, government debt is almost the only game in town.

FUNDING PROFILE The third area and also a function of cashflow and liquidity management is on the other side of the balance sheet: constructing the funding profile. Pre-crash, various models of funding for financial institutions were adopted. The model of originate to distribute supported by wholesale funding, as typified by Northern Rock, was at one end of the spectrum to the model adopted by a small traditional building society funded exclusively by retail deposits. "Depending on your business model and inclination," says Stunell, "you could be anywhere between the two."

Before the crash, as long as banks were not obviously taking on too much risk, funding was always available. Five years ago success or failure could be measured by a single basis point. Back then a single A rated bank issuing, say, a five-year floating rate note (FRN) in euro into a deep investor base could price at EURIBOR+10bp. Timing was key and planning was detailed, with the investor base identified right down to individual names.

"In those days basis point differentials were important," says Stunell. "If you thought you could issue at +10bp and ended up issuing at +11bp, you weren't very happy. Now you are talking in terms of differentials of 50 or 100 basis points. The world has changed dramatically."

CAPITAL Underpinning all this, of course, is the fourth item on the list: capital. Striking the balance between maintaining a strong and sustainable capital base and utilising it efficiently has always been a challenge for the treasurer. Right now it's a scarce and expensive resource, so we shouldn't waste it.

What financial institution treasurers think about

- Cashflow
- Liquidity
- Funding
- Capital management
- Structural risk management

STRUCTURAL RISK MANAGEMENT The fifth key area for the financial institution treasurer is structural risk management, which encompasses the main areas of liquidity, interest rate and foreign exchange (FX) risk.

Liquidity risk is about balancing the two sides of the balance sheet. "Over the course of the last 20 years the industry has moved a long way in terms of its appreciation and management of liquidity risk and with its role in maturity transformation. There used to be clunky controls whereby the bank maintained a liquidity portfolio which was a certain proportion of your liabilities."

The premise was that if you lost a certain amount of your funding, the financial institution could survive on its stock of liquid assets. As long as the instruments were deemed to be liquid, then it was seen as OK.

There were some hard and fast limits but it wasn't a sophisticated regime. Like any industry, the financial sector wants to sweat its resources more effectively. Now we have moved towards more sophisticated liquidity management metrics and regulation has become more stringent.

"Exploiting idiosyncrasies in markets and cheap profits have been flushed away and now we are in a position of significant stress in the markets to the extent that regulators want only very high-quality liquid assets on bank balance sheets. In terms of structural risk management, liquidity has moved up from something we always thought about and made sure we were managing correctly to the number one issue, and I can't see it falling down the charts soon."

By definition it is impossible to focus on everything and, with liquidity at number one at the moment, relatively less focus is placed on the other structural risks of interest rates and FX. "When liquidity was abundant, a key way for a treasurer to deliver extra value to the business was in managing interest rate exposures effectively, even though the difference between success and failure might only be a handful of basis points."

Stunell says that a key task is to make sure the profitability of the core business is immunised from movements in interest and currency rates. The treasurer must ensure that the balance sheet is constructed in such a way that it does not endanger the health of the core business. Mistakes can be made if risk appetite is not properly established, and structural risk taken deliberately or unwittingly

"LIQUIDITY HAS MOVED UP FROM SOMETHING WE ALWAYS THOUGHT ABOUT AND MADE SURE WE WERE MANAGING CORRECTLY TO THE NUMBER ONE ISSUE, AND I CAN'T SEE IT FALLING DOWN THE CHARTS SOON."

can have unfortunate consequences. The treasurer has to ensure the risk appetite is understood both by the main board and by the key subcommittee, the asset and liability committee (ALCO), to which the board has delegated responsibility to manage the balance sheet.

It will not have escaped anyone's notice that regulatory requirements are much heavier than they were. Stunell says: "I hesitate to use the word onerous because that would suggest they are inappropriate. The regulator's response has been understandable and justifiable but it has placed a lot of institutions under a considerable strain."

Asked about the lessons that financial institution treasurers can learn from the events of the last few years, he says: "Before the crash, while there were bumps in the road it was possible to set the strategy, build a plan, then see it succeed; and that was ongoing. Nobody really thought there were going to be any major obstacles to achieving what the organisation wanted to do."

It is clear that for many who worked in bank treasuries during that difficult period it was still a rewarding experience. Treasury teams carried on doing a good job in very difficult circumstances and while there may have been bank failures they rarely emanated from the treasury department. Arguably, there are even examples where treasuries kept the financial institution afloat. So what we have learned, not for the first time, is this: that treasurers can be pivotal in the success or failure of their institutions.

Peter Williams is editor of The Treasurer.
editor@treasurers.org

Structuring the balance sheet

Having joined RBS in October 2011, David Stunell now works for an organisation more than halfway through a five-year recovery plan. While it is progressing well along that path, some events – such as the euro zone crisis and regulatory changes – could not have been anticipated.

"Right now is the most demanding time of my career," says Stunell. "Everyone here is motivated to do a professional job and that is hard for all banks at the moment because markets, the regulatory agenda and tight cost control are challenging. Profitability in a low-interest environment will always be constrained."

In his present role as retail and wealth treasurer for RBS, Stunell has divisional responsibilities; previously his career had been spent in group treasury or smaller organisations with a single treasury department. RBS has a number of divisions, each of which have treasuries to support their own particular needs and which feed into group treasury.

But the key point Stunell emphasises is that the disciplines and procedures are common across organisations. "Essentially the job is the same: making sure the structure of the balance sheet is right, delivering capital efficiency and profit maximisation, and managing liquidity and funding."

Investors expect financial organisations to manage themselves in an appropriate fashion so they are looking to the bank's board to articulate strategy, explain the targets and map out the route to attaining the stated objectives. In particular, larger financial institutions are placed under a high degree of scrutiny. This leads to a degree of homogeneity in the sector, with big organisations adopting a similar approach. For instance, the risk approach around products on a retail balance sheet is similar. Credit cards, mortgages, loans, current and saving accounts all influence the balance sheet in different ways, delivering different margins and risk, but are treated in a similar way across different institutions.

As The Treasurer left Stunell's office in the City of London after the interview, he was turning his attention to the Financial Services Authority's individual liquidity adequacy assessment (ILAA), which is part of the regime and rulebook of the prudential sourcebook for banks, building societies and investment firms (BIPRU). All banks have to examine the components of the balance sheet in considerable detail and model the outcome of stress scenarios. This is a good example of how regulation and prudent treasury management can combine to make banks safer. With members of his team, Stunell was set to go through the ILAA report that afternoon.