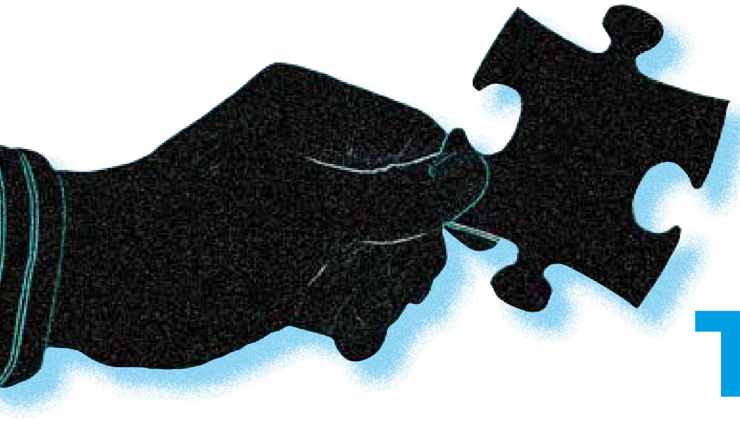
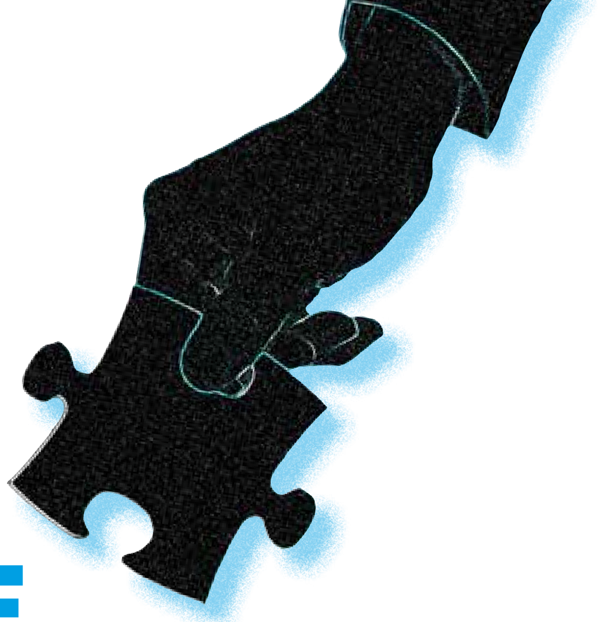
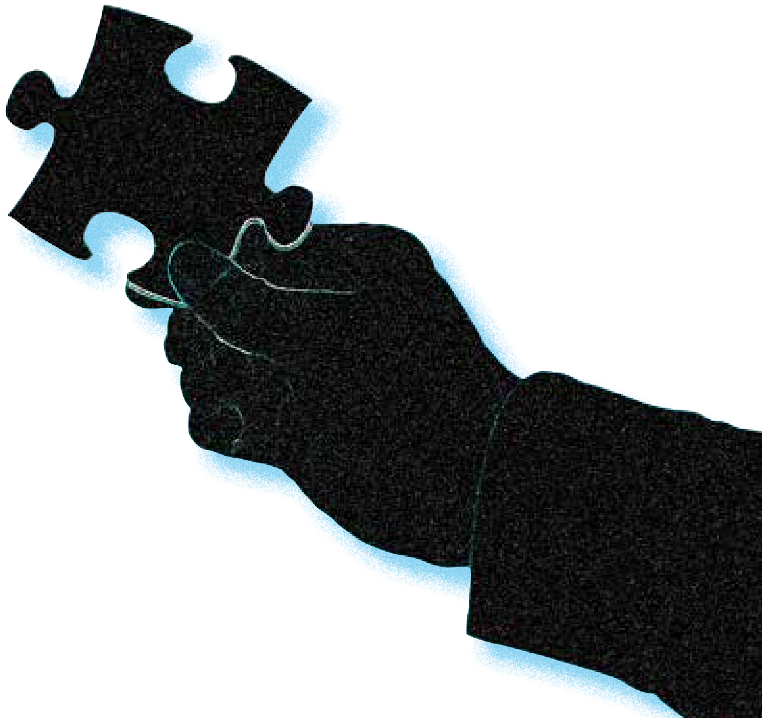




THE REAL DEAL

HOW DO TRI-PARTY REPOS WORK FOR TREASURERS IN PRACTICE? STEVE LETHABY EXPLAINS



It looks like 2015 will be a landmark year for tri-party repos, since an ever-increasing number of corporate treasurers are beginning to use this secured investment tool in their cash management strategy.

Regular readers of *The Treasurer* will have seen a number of articles from suppliers describing the process of using repos and the product's benefits in terms of security, flexibility and its ability to deliver yield pick-up. In this article, however, the spotlight is on the corporate treasurers themselves and their financial institution counterparties in terms of how tri-party repo really works for them.

First, let's quickly recap on the basics of using repos. The term 'repo' is short for repurchase agreement and under this agreement corporates receive collateral (defined securities) in return for cash for the duration of the trade with the financial counterparty.

At the end of the term, both the securities and the cash (plus a fee to the corporate – the 'repo rate') are returned. The tri-party element comes in when a collateral agent, such as Clearstream, handles all the administration, segregation, margining and reporting in addition to ensuring that the deal is closed out. The tri-party service fees are only paid by the counterparty that borrows the cash.

Diversification of cash returns

In short, repo is a very secure investment product for treasurers who are looking to widen their investment portfolio beyond term bank deposits and money market funds, or what Oleg Williamson, EMEA treasury manager of motion control technology company Parker Hannifin, calls "an old-fashioned investment policy".

"Our policy only allowed three-month investments, triple A-rated money market funds, straight deposits and interest-bearing accounts," he adds. "The repurchase agreement was one tool out of a larger toolbox that we were able to put into our new investment policy, enabling us to go much further and to use more diverse investment tools."

A powerful de-risker

Diversification is often an important motivation for using tri-party repo. "I think treasurers like a degree of diversification for their cash investments, and so it is a way to spread it around," agrees Stephen Webster, group treasurer of defence company QinetiQ.

"Most treasurers don't go out there looking for high-risk investments. We are typically risk averse, so we're looking to de-risk, and tri-party repo is clearly a very powerful de-risker because you are basically removing the counterparty risk of the bank itself."

Williamson further notes: "Tri-party repo allows security and better yields in times when people are beginning to lose cash in normal deposits."

The fact that the cash traded in a repo is fully collateralised – daily mark-to-market adjustments maintain this throughout the term – provides welcome reassurance to treasurers.

For Guy Ingram, brewer SABMiller's regional treasurer in Europe, there were a number of drivers for moving into repos in 2014. "First, it was access to alternative risk and then the ease of operation because we didn't want to have to manage collateral, margining, and the monitoring and compliance with our collateral debt definitions," he explains.

Meanwhile, Sven Weinhold, who is responsible for the sales trading at the short-term funding and interest rate management desk in UniCredit's corporate and investment banking division, feels that having a collateral agent take care of all the collateral management, daily and comprehensive reporting, and automatic processing of mandatory corporate events and income, has been an advantage in terms of managing operational risk.

A matter of choice

In the past, treasurers have sometimes been deterred from entering the repo market because of the contracts involved. The Global Master Repurchase Agreement (GMRA) has been the industry standard since its first iteration in 1992, but it has earned a reputation for involving lengthy (and therefore costly) negotiations. So, in 2013, Clearstream developed an alternative, the Clearstream Repurchase Conditions (CRC), in order to give its customers easier access to tri-party repos.

Rupert Stone, who is responsible for rate sales for Mitsubishi UFJ Financial Group, was quick to embrace the CRC. "I have been quite a big supporter of the CRC, especially having spent two years negotiating a GMRA," he says. "I thought that a standardised document made a lot of sense to simplify everybody's life."

A GMRA is negotiated individually between each pair of counterparties and it therefore covers both tri-party and bilateral trades. The CRC, however, enables a client to sign a single document setting out tri-party provisions and collateral acceptability options so that they then have access to all the counterparties within the Clearstream CRC community. The client decides which contract to use and they appreciate having the option to do so.

The number of counterparties that the corporate wishes to trade with might help to determine which contract works best for it. "The tickets we're using are typically fairly small for the repurchase environment," says Williamson. "So we didn't want to go into GMRAs with only one or two partners."

Quality assets

With capital preservation often the biggest priority for treasurers, many choose to take only high-quality liquid assets such as triple-A or double-A rated government debt as collateral, while others use the inherent security of the product to go further along the risk-return curve.

QinetiQ's policy is conservative – at present, the company will only take UK government gilts. There is no problem with receiving exactly the right collateral, says Webster. "We're looking for collateral for deposits of upwards of £50m and the banks tend to have plenty of gilts on their balance sheets."

Users of tri-party repos can accept ready-designated baskets of securities or they can specify their individual needs. "We have two sets defined," says Ingram. "We don't tend to worry which one we use and so it depends on what the counterparty has at the time."

Finding lower-grade collateral for corporates can sometimes pose a problem for the financial counterparties. "Institutions often tend to be more opportunistic in what we're doing with lower-grade collateral, so it has been quite interesting," says Stone. "It can sometimes be tricky for the collateral giver to fulfil the corporate's needs. But ultimately, we'll try to support their business where we can, so we'll work hard to get them what they need."

Pick up the phone

There is clearly a growing interest in tri-party repo among corporates. So what should treasurers do if they are thinking of taking the plunge? "I would say, just pick up the phone and call the banks and have a discussion," says Stone. "I think they will be very willing to help, and to start relationships with corporates and talk them through the process."

Ingram agrees: "We didn't know anything about it when we started off. I would advise treasurers to talk to three or four banks to understand the collateral side of it. And my advice would be that you don't want to compromise yourself, but you need to be flexible."

Whether you are looking for more security and yield pick-up or you are seeking to diversify your investment portfolio, it is clear that using tri-party repos has never been easier.

"Most treasurers don't go out there looking for high-risk investments. We are typically risk averse, looking to de-risk, and tri-party repo is clearly a very powerful de-risker"

Steve Lethaby is global securities finance sales and relationship manager (UK, Ireland, Americas and South Africa) at Clearstream

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