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Risk Awards 2015

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Risk solutions house of the year

SOCIETE GENERALE
Corporate & Investment Banking

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Societe Generale

Risk solutions, risk advisory, cross-asset solutions – whatever you call them, these groups have been on the rise since the 2008 crisis, as banks attempt to augment traditional product and asset-class siloes with teams that can muster a whole range of skills and deploy the full suite of financial engineering.

Most major banks now have these groups in one form or another, but Societe Generale Corporate & Investment Banking (SG CIB) stood out last year for the breadth of work it took on, which saw it financing retained securitisation assets for Santander, stepping into inflation swaps with a UK pension fund, and working with a host of corporates – including water and energy giant Veolia – on innovative approaches to emerging market currency risks.

That breadth means many clients see the bank as the go-to name when they want to work through a problem, or get a quick price on a non-standard product: "They are the first bank I call because they have a really good ability to propose solutions. And when I have an idea and I just want somebody to give me a price on a structured solution, they prove to be really reactive," says the treasurer of one European corporate.

"Part of our discussion with Santander was to say 'Let's try to anticipate and secure some financing ahead of the definition of the new refinancing by the central bank'"

Hubert Le Liepvre, Societe Generale

SG CIB's cross-asset solutions team was set up in 2009, and is divided into sales, engineering and trading. Within this, it splits into a distribution business – which sells products to the bank's clients for on-sale to their own customers – and institutional advisory business. The latter is split by client type, with separate groups for banks, pension funds, insurers, corporates and so on. Within each of these groups are specialists focusing on industry-specific issues – for instance, the corporate group includes accounting and tax experts, and can provide advice to corporates on new rules, such as the European Market Infrastructure Regulation.

As one example of their work, SG CIB's bank advisory team played a crucial role in helping Santander secure three-year financing against a portfolio of untraded asset-backed securities (ABSs). The European Central Bank's long-term refinancing operations (LTRO), which began in 2011, allowed banks to use very simple securitisations as collateral for financing. These securitisations, known as retained ABSs, contain good-quality assets but are typically structured purely to meet the LTRO collateralisation guidelines, rather than investor expectations. As a result, they utilise fewer rating agencies and provide fewer disclosures.

As it was unclear exactly when the LTRO would end, Santander wanted to lock in financing for its retained ABS assets to strengthen its liquidity profile. "Part of our discussion with them was to say 'Let's try to anticipate and secure some financing ahead of the definition of the new refinancing by the central bank'. For retained ABSs there was a question mark at the time. We know full, classical securitisations are eligible, but there's been a number of variations on what else qualifies," says Hubert Le Liepvre, head of financial engineering in the cross-asset solutions group in London.

The first step was to value the assets – a portfolio of auto leases. This was deceptively complex, requiring the team to consider the so-called consanguinity risk of receiving collateral that is very closely related to the funding receiver – Santander acted as the originator, account bank and servicer for the deals. The French bank also had to examine the structure of the securitisation swap hedging the retained ABSs. The task was made more difficult by the lack of a secondary market for these types of assets.

SG CIB brought in Markit to provide an independent valuation – one of the first times the firm had valued these types of assets. The final deal saw the French bank provide €207 million in cash financing to Santander on the portfolio of €250 million of retained ABSs, taking into account a haircut to mitigate the consanguinity risk.

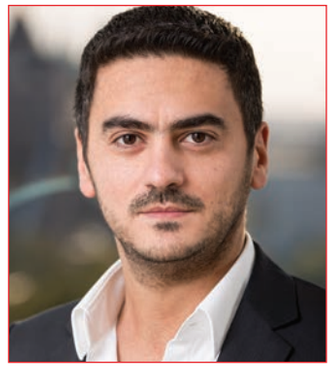
SG CIB didn't plan on keeping the collateral, though. Instead, before executing the deal, it found another client that was keen to take the Spanish bank's assets – France's La Banque Postale (LBP) – making it a back-to-back deal. LBP took on the ABSs in exchange for €220 million of French government bonds, which also took into account haircuts.

The repo-ing out of the ABSs underlined why it was important for SG CIB to fully understand the risk of that portfolio: "We're holding residual risk on the underlying ABS, so if LBP defaults and we end up getting back the assets on the other leg, we have to hold them to maturity. Even though it's a third-order level of risk, there's still residual exposure," says Marc El Asmar, global head of sales in the cross-asset solutions team in London.

To reflect the amortisation of the auto leases over time, the structure also embedded a feature in which Santander would repay the euro cash

financing to SG CIB as the leases in the ABS amortised. LBP would receive the equivalent amount in French government bonds back from SG CIB, with the latter taking the transformation risk. SG CIB modelled the underlying leases ahead of execution using different prepayment assumptions to price this risk.

Santander was delighted with the result: "From the in-depth valuation of the collateral to the amortisation schedule they accommodated us with, SG CIB stood out in designing the tailor-made solution that exactly matched our long-term funding needs," says Gema Bermejo, a director in the debt capital markets department of Santander Consumer Finance in Madrid.


Marc El Asmar, Societe Generale

SG CIB's pensions team was presented with a very different problem at one point last year, when regular discussions with one large UK corporate pension fund revealed it had concerns about counterparty concentration risk – its inflation hedging programme was heavily reliant on a handful of UK banks. Despite not being a traditional player in the UK inflation market, SG CIB analysed the portfolio and agreed to step into a £1.2 billion portfolio of 10 swaps referencing the UK Retail Prices Index, with maturities ranging from 25 to 35 years, that had originally been traded with one UK bank, helping to diversify the client's counterparty exposure.

Elsewhere, SG CIB's corporate advisory team saw a growing stream of emerging markets business, working both with multinational companies and domestic emerging market customers.

"We've seen some headwinds in the market, increasing volatility in some currencies, and increasing hedging costs as the forward premium is rising in some currencies. It's an important topic to discuss with clients. The markets are complex, and the regulatory and tax environment is complex. The bottom line is that the emerging markets are a fantastic space to develop a company when you're chief executive officer, but it's very difficult when you're a chief financial officer," says Antoine Jacquemin, global head of the market risk advisory group.

SG CIB spent a lot of time helping clients optimise their short-term emerging market hedging policies. Traditionally, a corporate might use a currency forward or forex swap to manage the risk exposures, but this can be expensive when the currency is strong.

Instead, SG CIB advised a number of corporates to enter into a so-called enhanced forex swap. This consisted of a risk-reversal strategy – in which it buys an out-of-the-money put option and writes an out-of-the-money call option every month – which restructures into a longer-term forward if the currency depreciates beyond a certain threshold.


Antoine Jacquemin, Societe Generale

This means the corporate can participate in some upside when the currency slowly appreciates, and if it sharply depreciates, as emerging currencies often do, the company can lock in, say, a three-month forward at a cheaper rate as a proxy stop-loss measure.

An added benefit is that the hedging costs are accounted for in the cashflow hedge reserve in the equity section of the balance sheet, meaning changes in the value of the positions do not have to be reported as profits and losses (P&L).

Edouard Nguyen, part of the group treasury at Veolia in Paris, says the company had been thinking of moving to options-based hedges from its traditional forwards, not only to tackle the cost of hedging but to improve the financial performance of the business.

"SG CIB came up with a detailed analysis of what would be the result of the collar depending on the reset frequency, the deltas of the options and the considered currencies, so we could fine-tune our strategy. In addition, we had an in-depth discussion on the accounting treatment, which resulted in significant savings with minimal P&L volatility," says Nguyen.

"To me, this is really an example of the unconventional ability of SG to analyse its clients' issues and to see more broadly than just pure foreign exchange derivatives," he adds.

The team also worked with a number of companies looking to rebalance the currency of their outstanding debt, to help lower hedging costs and improve financial results. One example saw SG CIB advise a multinational with significant exposures to South Korea to move several hundred million dollars of debt into Korean won via a seven-year cross-currency swap. This is because the won is relatively cheap to hedge in for an emerging market currency, boasting low forward premiums and low interest rate spreads compared with the US dollar and euro.

The French bank spent a lot of time with the company, examining the impacts from a risk and cost perspective, and subsequently executed the swap.

"The key was having an early understanding about how deep this market is and what the optimal size is I can execute on a given day. For instance, do I need to tranche it or not; if I tranche it do I have to wait a few days or weeks; how will it go and how will it work? You need to anticipate that at the early stage – if you are about to rebalance $500 million, you need to present to the board how long it will take and the risks that are present in the transaction itself," says Jacquemin.

It wasn't just forex hedging the bank helped corporates out with – it was one of the first to come up with a way to provide certainty on the funding charge an uncollateralised hedger might have to pay when unwinding an interest rate swap. If the trade had a positive mark-to-market for the company, the bank would normally be receiving collateral on any associated hedge it had transacted elsewhere, but would not have to post it on – creating a funding benefit. Unwinding the swap would increase the net funding requirement for the remaining portfolio. This amount is unknown at the time of entering into the trade, but SG CIB provided a cap on the funding valuation adjustment charge the company may have to pay in an unwind.

"Say the client is using a swap to put a fixed-rate bond into floating. When the rate decreased they would like to take profit and keep the bond at fixed, but they don't want to have too much difference with their mark-to-market when they take profit," says Pascale Moreau, global co-head of fixed income and currency sales in Paris. The bank was willing to discuss the mechanism during the *Risk* awards pitch, but declined to provide further detail for the record. **R**