Treasury Strategies

The Power of Experience®

The full force of financial services regulation is about to come crashing down onto the desks of corporate treasurers. One of the potentially most disruptive regulations, Basel III, is right around the corner. Be prepared.

When "they" change the rules of the game, it usually changes the winners and losers. Add the three-point shot to basketball, and different players become the top NBA draft choices. Add or take away a tariff, and an import or export market suddenly prospers or dies. New rules can completely change what works.

Basel III Changes the Rules

"They" are changing the rules of banking with Basel III, imposing a new capital "tariff," which will impact borrowers, depositors and service users of all major banks. Many corporate treasurers regard Basel III as an obscure banking matter. Yet, Basel III could have significant corporate impact. Companies courted by bankers today could be shunned tomorrow. Banks will judge corporate clients by different standards, beginning in the near future. Depending on the nature of what you buy and the services you use, they may not place the same value on your business as they have in the past.

Properly structured and presented, your business could be more valuable to your banks. Leaving it to chance could render your business less valuable. What you learn and do now may help you influence that.

The Details—How You Are Affected

Among other things, Basel III brings tighter regulation to the liability side of a bank's balance sheet, putting a premium on stable deposits. Important new ratios will be applied to determine required capital. Required capital will soon be linked to the quality of a bank's liabilities, which will certainly affect credit availability, appetite for deposits, and pricing for certain services. This is likely to change banks' financial strategies and cause them to introduce new incentives for the relationships and deposits that help their ratios, and new disincentives for those that hurt.

Although some of the fine points of Basel III are still being worked out, the broad principles have been settled. And while there's no global enforcement body—each country has the sovereign ability to determine how the rules apply to its banks—there will be strong pressure to make enforcement homogenous. Bank regulators certainly don't want to see arbitrage across political jurisdictions.

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Historical Perspectives Turned Upside Down

Corporate treasurers have historically valued banks for the liquidity they can provide. Soon, banks will value corporate treasuries for the kind of liquidity they can provide. Treasuries have historically looked to banks for stability, places they can move money into or out of at a moment's notice. Soon, banks will look at corporations according to how much they add to or take away from the bank's stability. From the bank's perspective, companies that consume stabilizing products and services, and that provide stabilizing deposits, will be more highly sought after. Those with destabilizing products, services, and balances will almost surely pay a higher price—if they are banked at all.

Until now, corporate banking relationships have been carefully constructed around coinciding sweet spots, where the products and services most important to treasury are the products and services their banks are most interested in providing. Basel III essentially alters a bank's sweet spot. Banks will continue to look for ways to earn the highest return on capital, but the roads to get there will be different, and will probably vary from bank to bank. The changes will be so profound that some companies may have to look outside of banks for services, funding or cash investing.

The type of deposit a bank used to covet may now be an unwelcome burden. One can imagine many cases in which a bank would no longer accept volatile deposits. Daily sweeps into investment vehicles might be unattractive. Instead, banks will court particularly stable depositors. Firms paying with compensating balances may become more attractive.

Many companies still operate with Treasury 2.0 structures. They have traditionally allocated their banking services based on functionality. For example, they have one group of banks for collection services, another group for disbursements and payroll and yet another for concentration and investments. In effect, this practice may take a very stable stream of cash flows and disaggregate it into smaller, more volatile streams. That, in turn, could make the company's business less attractive and profitable to banks who are now concerned about meeting specific liquidity coverage and net stable deposit ratios. Treasury 3.0® banking structures will be required; virtually every company will need to change major parts of its transaction business to get there.

Some banks have specialized in certain product lines that naturally generate high deposit variability. These may be assessed a higher internal capital charge, becoming unprofitable to offer. The corporate customers using those products will have to find substitutes.

The Banks Respond (Or Do They?)

A recent Treasury Strategies survey asked banks basic questions about their Basel III response teams. We found that banks' risk management and compliance gurus are taking the lead, assisted by the finance gurus. The lines of business heads (like Corporate Banking and Treasury Management) are less involved. So the key decision-makers at this point are less familiar with the needs of a bank's corporate customers. Corporate treasury staffs and corporate banking staffs have a mutual interest in entering the conversation and a limited time to do so.

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What's a Corporate Treasurer To Do?

What we conclude from this survey is that it's time to restart the mating rituals and open serious conversations with your banks—and perhaps with banks that haven't been your banks. And here's where you're likely to run into your first disappointment. Your bank contacts—the people who run the corporate products and services businesses—are *not* the people who are planning how the bank will respond to Basel III. At this point, your best sources of intelligence and your best potential advocates within the bank probably don't even have a seat at the table when post-Basel III planning is discussed.

For corporate treasurers, the stakes are very high. Commercial banks, for many, are the primary sources of credit; that will change for some firms. Commercial banks are the primary repositories of corporate cash, and that will also change for some firms. Commercial banks are the primary providers of transaction and payment services. That too will undergo disruption.

The key to corporate treasury success is to be proactive. Know your bank. You must begin to understand all the subtle ways in which your company can be more or less attractive to your banks. The answer will likely differ by bank, depending on the bank's asset and liability composition and the nature of its funding.

Just as anti-money laundering and then anti-terrorism finance created a mandate for banks to "know your customer," there should now be a mandate in the corporate treasury world to "know your bank."

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Armed with new information about relationship value drivers for each of your banks, you can intelligently consider how to restructure bank credit and services networks. A smart treasurer will realign and reallocate services in a win-win for the company <u>and</u> its banks. A treasurer who lags will almost certainly have higher operating service pricing and less attractive interest rates, and may even find themselves turned away at the door.

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