



Safeguarding liquidity in a changing environment

Nick Gant, head of fixed income prime brokerage for Europe, the Middle East, Africa and Asia-Pacific at [Societe Generale Prime Services](#), discusses banks' evolving responsibilities for providing liquidity in a post-financial crisis environment in which tighter regulation restricts the ability to take a flexible approach, and how Societe Generale Prime Services works with clients in need of liquidity to tailor its offering in a continuously changing market

The role of banks is changing. Having traditionally acted as liquidity providers for their clients, a shifting landscape has seen banks' responsibilities evolve in turn.

Banks should and will continue to offer a 'one-stop shop', providing everything clients need to trade – which includes ensuring the ability to meet clients' liquidity requirements now and in the future. To achieve this, the flexibility to act as an agent is key to providing continued capacity.

In recent years, a number of unforeseen market shocks have impacted available balance sheets. In particular, squeezes focused around the past two calendar year-ends have rendered liquidity more difficult to come by. The advent of more stringent regulatory requirements has further complicated the resulting liquidity challenge. Against this background, it seems prudent to use an agency offering to generate liquidity, or at least to provide clients with solutions that enhance liquidity.

Regulatory tightening

The fallout from the 2008 financial crisis led to a necessary tightening of regulatory requirements. Regulators took the view that the flexible approach many banks had adopted in allocating balance sheets had contributed to the crisis, so they took the opportunity to reduce leverage, making it more costly for banks to offer balance. The introduction of the liquidity coverage ratio and net stable funding ratio, which imposed new requirements on banks' balance sheets, soon followed. This made sense because the new models were more reflective of the true cost of balance sheets.

As a result, banks' approaches have needed to change; balance-sheet compression and repricing has certainly occurred since 2008, with the methodology of allocation to clients also evolving.

As an example, one institution around 10 years ago would give away balance sheet in exchange for a couple of basis points. Then, there were fewer regulatory pressures, the balance sheet was freely available and it served as an effective



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way of bringing new clients on board for a small, quantifiable cost.

In truth, there is still some flexibility. It is as true as ever that acorns can grow into oak trees, so a holistic approach is paramount in nurturing a long-term relationship. A prospective client may not clear the first hurdle on day one. However, if there is a realistic expectation that it may in the future, Societe Generale Prime Services wants to help them achieve that. It's a symbiotic long-term approach. If business planning is built around and undertaken with longevity in mind, all of our clients should fit into our strategy for the future and each have their own place within it. If a client does not make the hurdle rate, there must be a solid assumption that they will in the future.

When presenting this portfolio approach to clients, it is vital to recognise each is at a different stage of their respective growth cycle. Prime brokers, for example, ideally want long-term, 'sticky' clients. Any relationship should work as a partnership, so it is

imperative to identify potential clients whose profiles fit the broker's style. It is these that have the potential to become long-term partners.

Ensuring any and every plan is focused on the long term requires calculating the revenue and cost of the scarce resources available, and providing the client with as much capacity as possible. A prime brokerage should then do everything it can to help them grow throughout the partnership. That extends to ensuring they can access liquidity.

Repo-clearing offerings

Within our own business, the recent development of a repo-clearing collateral management solution was driven by change and new constraints in the marketplace; Societe Generale Prime Services used those constraints to identify opportunities to help clients. Having all products and services under one roof facilitates a more agile and flexible environment.

One approach is to invest in and develop a platform that brings together all



cross-asset capabilities and links multiple custodians and other service providers. This facilitates easy conversations between the teams that deal with listed derivatives, foreign exchange, equity, fixed income and all other asset classes. It enables a bank to be entirely agnostic as to whether it offers an agency or principal solution to any given client. From the multiple solutions made available, the most appropriate one – or more – can be chosen to create a bespoke solution, tailored to any individual client's needs.

The repo-clearing offering is a good example of a client-based solution. It is currently offered by only one other bank and has certainly polarised opinion.

Some argue that there is no sense in letting the buy side into the interdealer market, which has previously always been the domain of banks sharing liquidity. This view is seemingly underpinned by a belief that the buy side would not possess the requisite infrastructure – or indeed the understanding – to make it work. But Societe Generale Prime Services took the view that, if a sudden squeeze on liquidity occurred, alternative solutions would be critical in maintaining a fully functioning market. Getting the buy side involved offers part of that solution and helps to future-proof clients.

The value of this approach may not be immediately apparent today, but there may come a time in the future when it proves crucial.

The need for liquidity is just one of the challenges faced by prime brokers today, and we are taking the same client-focused approach to tackling them all. If every communication with a client is driven by a desire to find out more about what the client wants, prime brokers can then use those conversations to inform what they go on to deliver.

Societe Generale Prime Services relies on the input of its clients to keep developing its offerings in those areas, and must continue adapting to a market that is always changing.

Innovation to provide liquidity

I have worked in this space for 30 years, and have seen more change over the past 10 years of my career than in the first 20. As previously mentioned, the regulatory side has had a huge impact both in terms of capacity and on the mind-set of the financial services industry.

I recently spoke to an asset manager with 14 legal agreements in place with various banks to serve as liquidity providers. However, by month-end, only four were able to provide liquidity at all.

In both of the previous calendar years, this liquidity shortage has been magnified even further at year-end. This is obviously not an ideal solution for any client, and seems to be an issue confronting the entire banking industry. However, if banks can continue to develop innovative ways to find and provide that liquidity to all clients on a principal and agency basis, irrespective of market conditions and whatever shocks may lie in store, this situation will offer the opportunity to continue to grow business while ensuring nothing gets in the way of clients growing theirs.

The development of new models is an ongoing project, and the debate around it is unlikely to calm down any time soon. But we will be at the heart of that conversation, whether in our client meetings or in broader industry forums.

We have already shown we are finding solutions to the challenges we face, but are equally keen to take on board any other new ideas. As part of that commitment, Societe Generale Prime Services invites any thoughts or contributions – please email your ideas, comments or suggestions to PRM-Enquiries@socgen.com
