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Derivatives house of the year
Equity derivatives house of the year
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Risk Awards 2015

Derivatives house of the year

Societe Generale

For dealers, the financial crisis has been followed by an identity crisis. More than six years after the collapse of Lehman Brothers, banks are still working out what businesses they want to be in and how best to offer them, a task prolonged by evolving regulations and record-low interest rates that are putting a brake on fixed income, the traditional motor of the franchise. For the most part, and particularly among Europeans, dealers are on the back foot: reviewing, revamping, retrenching and reluctant to commit capital to new businesses and new ideas.

Societe Generale (SG) is an exception. The bank decided a long time ago that it wanted to be an equity derivatives powerhouse, with cross-asset expertise when it comes to advisory, solutions and structuring, plus just enough fixed-income clout to meet clients' needs.

"SG has been consistent in doing what we are best at doing. We have a policy to be relevant with the accounts and businesses we have chosen – for example, equity derivatives – but also to build around this where the markets are changing and we see opportunities," says Didier Valet, the bank's Paris-based head of corporate and investment banking (CIB), private banking, asset management and securities services.

It's the kind of bar-bell strategy many other houses aspire to – strong in complex, high-margin businesses, while executing low-margin flow business cheaply – but SG's long-standing commitment to the model has two great advantages. First, it means the bank has become a fierce competitor in its chosen markets and is able to tell clients, investors and regulators a consistent story; second, it's a mix that is very profitable – return on equity (ROE) for SG's global markets businesses was 18%

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> Didier Valet, SG CIB

during 2013 and 17% for the first nine months of last year – giving it more freedom to invest and innovate, particularly in places where other banks are choosing to cut and run.

As examples, the bank finalised the acquisition of Newedge in May last year – the big futures and options broker and clearer it had previously co-owned with Crédit Agricole – and hopes regulatory tailwinds plus an integration budget of €118 million will turn the struggling business into a

Photo: Christian Fournier

Christophe Mianné (left) and Didier Valet, Societe Generale

cross-selling engine. SG also snapped up four credit default swap (CDS) portfolios worth a total €140 billion in 2014, during a period when some players have been backing away from the market, and stepped into a portfolio of inflation swaps with a large UK pension fund.

These are capital-intensive businesses – or, in the case of Newedge, low-margin ones – but SG's profitability makes it easier to integrate them, says Christophe Mianné, deputy head of CIB, private banking, asset management and securities services in Paris. More to the point, the pressure other banks are under means there are bargains to be had. Being contrarian "is where you capture value sometimes," says Valet.

Among recent innovations, the bank revived the market for index credit-linked notes (CLNs), showed off a new approach to the longevity business in a €1.4 billion trade with Dutch insurer, Aegon, and designed an index that allows clients to access the Euro Stoxx 50 without incurring the costs that arise from the structural collapse in equity repo rates. Trades of this kind helped the bank win this year's awards for equity derivatives and for risk solutions – it was also a strong contender in structured products (see pages 4–5 and 6–7).

But SG can also point to a rich legacy of innovation, from the first equity correlation swaps to the organisational innovation it displayed in 2003 when creating a cross-asset solutions group within CIB, where non-linear products of all stripes are handled by a single group of traders and risk managers.

SG had a hand in finding its path – and committing to it – from an unlikely source: Jérôme Kerviel, the rogue trader who lost the bank €4.9 billion. The losses, announced at the end of January 2008, could hardly have come at a worse time, forcing a restatement of SG's 2007 earnings and kicking off a brutal year for the bank and the markets (*Risk*

February 2008, *www.risk.net/1506258*). SG CIB booked a loss of just over €2 billion for 2008, while the bank's share price fell almost two thirds.

It could have torn the markets business apart – Mianné says some investors pressed the bank to exit the more complex corners of investment banking – in fact, it forced SG to agonise about its identity far earlier than its rivals, and the bank came out of the process stronger, more focused and more committed.

"Many banks had their baptism moment during the crisis, and ours came earlier than most," says Daniel Fields, the London-based head of global markets. "I think Kerviel was notable because it solidified the team enormously. The loyalty to the business, and the feeling that these are our markets, was tangible in the post-Kerviel period. The teams were determined not to let Kerviel destroy what we'd built over the previous decade."

Mianné says: "We faced strong pressure to close all the exotic and structured books, but we decided to keep them. We have the DNA, the people, the clients and the systems."

Traders who joined SG at the time found an institution in the throes of painful, cultural change, but change that was ultimately for the better.

"It was like nowhere else I'd been at that point," says one former member of the CIB team. "The organisation became more introspective than other houses because they had survived something existential. You had senior risk-takers that were very focused on operational issues, post-trade issues; they wanted to know how certain products settled, where they cleared. Appropriateness of trades became a very hot topic within the bank well before the recent scandals and fines."

A senior equity derivatives trader at another bank puts it more simply: "If you go through a near-death experience – which those guys did – it traumatises you. But it has also made them very close-knit."

They have certainly proved durable. Valet has been with SG since 2000, but only moved into his current role in 2012 – taking over "part-way through the journey," he says. Mianné joined in 1988, with Fields coming on board in 1994. David Escoffier, chief executive of Newedge and deputy head of global markets, joined in 1999. Eric Litvack, SG CIB's head of regulatory strategy – and the recently appointed chair of the International Swaps and Derivatives Association – has been with the bank since 1986. Danielle Sindzingre, the bank's global head of fixed income, credit and currencies, has been with SG since 1997.

It's hard to think of another bank with that kind of longevity in the management team for its markets business. "It's remarkable," says Fields. "I think much of what we do works because we've known each other for a long time. The managers in my executive committee have been here for an average of about 20 years. Everybody I work with has been here in that range of time. And that just means the conversations are fluid, the conversations are open."

Clients and analysts agree the bank stands out, with many focusing on its willingness to be creative and embrace complexity. The treasurer at one big European corporate says SG is the first bank he calls when looking for advice on complex problems; the head of equities at a smaller investment bank says his firm did several correlation swaps with SG in 2014, claiming few, if any, other banks are still willing to price the trades; a senior private banker says he wishes he could distribute more of the bank's structured products, but has run into his firm's per-issuer concentration limit.

Kinner Lakhani, a bank analyst with Citi in London, notes SG had a second brush with catastrophe in the form of the US dollar funding squeeze that hit French banks in August 2011, before spreading to affect many other European names. Valet, formerly the group chief financial officer for SG, took charge of the CIB division five months later, leading a revamp of its liquidity and funding structure (*Risk* October 2012, *www.risk.net/2213391*).

Photo: Scott Williams

Daniel Fields, head of global markets, SG CIB

Since then, Lakhani says the bank has been "generally been more disciplined and conservative" than its peers: "Where individual banks are today depends to a large extent on strategy and how quickly management got to grips with the new realities of this market. If you look at some of SG's competitors, they have been more ambitious and that has diluted their overall returns; I don't think the penny has dropped for some of them. In contrast, the past three years have seen SG generating Basel III returns of 15% on average, which is very respectable."

Jon Peace, a London-based bank analyst at Nomura, says the group's main challenge is improving the profitability of its international retail banking business: "The CIB business is clearly the jewel in the crown, with good cost efficiency and ROE compared with peers. SG has focused on its strengths, is the undisputed leader in global equity derivatives, particularly on the structured side, and has rightsized its cash equities and flow fixed-income business. The acquisition of the balance of Newedge is a good example of how the bank is looking to invest to grow the business."

The Newedge deal might initially look out of step with the bank's strategy. SG acquired the remaining 50% of the stake via an asset swap – with a 5% stake in asset manager Amundi going the other way – but in doing so ended up owning a business that has seen its earnings and market share slip in recent years, and is all about the nuts and bolts of execution, margining and clearing, rather than the complexities of options pricing.

That was exactly the point, says Valet: "Newedge is clearly additive in terms of clients to our franchise, and means we can capitalise on the growing importance of derivatives clearing and of post-trade services. We

feel there is going to be more and more stickiness or integration between execution, clearing and custody."

To put it more bluntly, Newedge brings with it more than 450 hedge fund clients, many of which were not previously trading with SG, and also allows the bank to offer new services to its existing customers, such as collateral transformation and optimisation, or equity prime brokerage, where it previously had to send many clients to other banks.

But Valet notes the business needs turning around as well. The aim, by 2016, is to cut €80 million in costs from Newedge and generate €120 million in additional revenue.

That work started in earnest on Escoffier's first day in the job, when calls had been convened with 24 of the firm's biggest clients. The idea was to explain that Newedge would be integrated into SG, benefiting from the bank's balance sheet and also a fresh injection of energy: "It is a competitive market, and futures and options volumes were down roughly 20% globally last year, so we were mindful the change of ownership might become an excuse for some clients to exit – but none did – it was only positive. With SG's credit strength behind Newedge, as well as fresh direction and focus, many of the clients said they would be giving us more of their business, and they are doing that," says Escoffier.

Since then, the bank has been trying to deliver some of the early cost savings available through integration, for example by pooling and harmonising IT resources, and merging some legal entities. It has also been testing the cross-selling benefits it hoped to see, creating a client management unit within Newedge to focus those efforts, giving customers access to the 155 different markets and 62 clearing houses Newedge is connected to, as well as opening up SG's capabilities.

Escoffier says he remembers the first over-the-counter derivative – a $200 million interest rate swap – that was sold by a Newedge team in the US to one of its existing clients in the second quarter last year. The client had previously only used the firm for futures and options broking: "Those first sparks, those first successes are very important, and we now have a flow of them."

SG's clients also stand to benefit, says Fields: "One of the most heartening things about the Newedge deal is that we've seen the industrial logic is real. What I mean by that is we have a good, global hedge fund business, but have often had funds asking what other business they can do with us – whether they can sign on for prime services, for example, and until 2014 the answer was always that we do not have prime, or we don't do listed products. The product range was limited to the OTC space, and did not include a lot of the financing they needed and that we would be happy to provide. Newedge completes that whole order."

In cases such as this, where the bank is expanding into mature businesses, it is humble. In providing equity financing for hedge funds, for example, it will be going toe-to-toe with established powers such as Citi and Morgan Stanley.

Mianné says the idea initially is to pick up some of the clients these firms are leaving behind as regulatory pressures force them to refocus. "We are not the only ones in this field, so we are humble, but we believe second-tier hedge funds need prime brokerage these days, and we believe we have the possibility to exist on this map," he says. The bank has set aside balance sheet to build the service this year, and Mianné suggests it should be able to generate "a few billion" euros of business fairly quickly.

When it comes to markets where SG has an edge, it is more assertive: "We are a smart bank. Our genesis is equity derivatives and structured

Photo: Scott Williams

"It is a competitive market, and futures and options volumes were down roughly 20% globally last year, so we were mindful the change of ownership might become an excuse for some clients to exit – but none did – it was only positive" David Escoffier, SG CIB

products. We have a lot more to offer now, but that is where we started out, and it comes with a focus on engineering and advisory which I think defines who we are today. I don't see that as arrogant – I think that's recognised," says Fields.

A good example is the CDS portfolio purchases. The deals were with two large European banks, closing in June and September, with the portfolios consisting of matched bought and sold positions. This makes the capital requirements for the trades immaterial, the bank says, but netting is not fully recognised by the leverage ratio, meaning the deals generated additional leverage exposure of around €5 billion.

There has been keen competition for these portfolios, with around three to five banks bidding in each case. SG's edge was the fact that it was able to achieve a "good" level of netting between the leverage exposures coming from the CDS portfolios, and the index roll positions that come from the bank's CLN business. "In a way, CDS purchases and the CLN business fuel each other, creating opportunities to buy portfolios on one hand, and reducing some of the roll positions in the CLNs on the other," says Mianné.

As a result, SG was able to bid more competitively in portfolio auctions, and also ramped up CLN issuance to €2.5 billion over the course of the year, with most of these trades being linked to a tranche of risk on CDS indexes, including Markit's iTraxx Crossover and high-yield CDX. Examples included notes that paid a 6% annual coupon as long as fewer than six index constituents suffered a credit event, and another that paid 3.5% if fewer than 21 reference entities defaulted. The products were a hit with private banking clients that were looking for higher-yielding products.

"It has allowed us to be among the best banks out there for simple, credit-linked products – private banks are telling us we're one of the only houses still active in this market," says Mianné. **R**

Risk Awards 2015

Equity derivatives house of the year

Societe Generale

To many, the marriage of Societe Generale (SG) and Newedge last year looked like one of convenience – the French bank bought the rest of the agency broker from wantaway joint owner Crédit Agricole after the two banks reportedly considered selling their stakes. SG's executives see it more as the happy culmination of a long courtship.

Previously the only top-tier lender without an equity prime brokerage business, the bank has, at a stroke, gained one of the largest footprints in the business, giving SG's equity finance desk access to a roster of 450 hedge funds (see pages 1–3).

But the biggest win is on the execution side, says David Escoffier, deputy head of global markets at SG Corporate & Investment Banking and Newedge chief executive. SG has grown its brokerage footprint 10-fold in terms of volume by combining it with that of Newedge, which commanded a market share in listed derivatives of 13% globally, to form an agency execution powerhouse.

"At SG, we have always looked to offer agency and principal execution to our clients wherever possible. With Newedge, our agency staff has increased fourfold to 400 account executives. We can concentrate all the orders we have from, say, futures rolls and option blocks, where we have both an agency desk and an internal trading desk. Newedge also has a very large electronic access team, which, combined with SG's e-commerce team – as our new global execution services unit – means our clients can access 155 markets via one connection. That's clearly something we couldn't do before," says Escoffier.

Photo: Scott Williams

"At SG, we have always looked to offer agency and principal execution to our clients wherever possible. With Newedge, our agency staff has increased fourfold to 400 account executives"
David Escoffier, SG CIB

The agency ethos sits well with SG's resolve to remain a risk-conscious flow house, crossing as many client orders internally as possible and warehousing fewer risks. But SG is not slow to set aside capital if it spots a good opportunity: for instance, it won a mandate for a multi-billion US dollar accelerated stock repurchase for a US corporate client last year, beating a field of mainly US rivals by virtue of its quicker response.

This mix of capabilities seems to be paying off: despite a poor first half for many equity derivatives businesses, when revenues among the largest dealers collectively shrank by almost a fifth, according to data from Coalition, SG's revenues climbed 11%.

The bank's powers were put to the test when volatility surged during October, peaking in the middle of the month, following the collapse of the $54 billion mega-merger of pharmaceutical firms Shire and AbbVie (*Risk* December 2014, *www.risk.net/2384515*). With the Euro Stoxx 50 shedding 4.2% on October 15 and 16 and the Nikkei skidding 3.2% on the second day alone, the bank expected a surge of demand for dispersion plays on the major indexes, in which clients take opposing positions in index and single-stock options. Any bank transacting that flow would acquire significant volatility exposure to the indexes. SG anticipated the demand, and sought to begin offloading the exposure to hedge fund clients as soon as possible.

"To be able to do that profitably, you need a deep and diversified client mix," says Stéphane Mattatia, SG's global head of financial engineering. "When clients know they can come to you when markets start tumbling, it creates a virtuous cycle; you get to see most of the flows, so you have a better perception of what's happening in the market. You can take more risks and afford to be more aggressive in the knowledge that, in the end, you're going to be able to match those flows. In the old days, you could take on that risk and hope for the best. Not any more."

In addition, SG saw a huge amount of big-ticket hedging on the FTSE 100 index on October 15 and 16, for example taking down a €1 billion hedge that had been due to expire in December 2014 for one client and selling a £200 million call for December 2020 to another. This is the fruit of a concerted attempt to build its flow

business with big UK institutions, which has seen the bank rise from an also-ran to among the largest players on FTSE hedges.

Product innovation is another area where clients say SG is ahead of the pack. Last year Morgan Stanley won the equity derivatives award, partly for correctly anticipating the collapse in long-term equity repo rates on major indexes and hedging its exposure using forwards; but in 2014 dealers found themselves cornered by a rise in hedging costs (*Risk* January 2014, *www.risk.net/2319109*). SG went looking for a longer-term solution to what it believes is a permanent market dislocation.

The exposure to equity repo arises from the structured products business, in which dealers sell huge volumes of index calls to clients – via autocallable structures, for example – creating a short forward and long repo position. In the past, banks could hedge this exposure reasonably cheaply by buying forwards, futures or trading total return swaps. Other banks' delta one desks often act as the counterparty, but accreting layers of costs have choked off that supply, causing the equity repo level to collapse and hedging costs to rise (*Risk* August 2013, *www.risk.net/2285279*).

A client buying an at-the-money call on the Euro Stoxx 50 with a delta of 50%, could end up paying 3–4% more than it ought to because of this dislocation, says Mattatia.

Frustrated by the rising costs of the existing hedges, SG set out to build an alternative. In partnership with Eurex, owner of the Stoxx Indexes business and winner of this year's exchange category, it developed the Euro Stoxx 50 futures index (*www.risk.net/2387886*). Because the index can be replicated very cheaply, by rolling short-term futures on the Euro Stoxx, it is a far cheaper hedge for equity repo exposure, says Mattatia.

"Rolling futures on Euro Stoxx generates a repo cost. But I'm rolling three-month positions, and the uncertainty that is priced into the short-term rate is considerably lower than it would be for, say, an eight-year forward. The three-month repo on Euro Stoxx futures is around 40 basis points. For long maturities, that number would be more like 120 bp. For a client, that equates to a discount of about 7–8% on the cost of their hedge. Even if we sell them an at-the-money call, that would be cheaper by around 4%. That gives them more flexibility if they want to trade slightly out of the money or buy some protection," says Mattatia.

So far, the bank has executed €800 million worth of options on the Euro Stoxx repo rate for clients, with the first-ever trade being a clip of €300 million on the one-year rate in October 2014. This enabled it, in turn, to buy back spot-repo correlation.

"This is a great illustration of why we're proud of our simplest ideas," says Mattatia. "We went to Euro Stoxx with the idea because we want this to become a reference price. If we had gone out to our clients and simply explained the methodology behind the index, it would look highly complex. But when you explain the principle and tell people that it's now our preferred way of hedging, they get it. We would be happy if all the other structured products providers piled in. What we don't want is for everyone to create copycat hedges using different futures, because it would be confusing for all our clients."

Another point consistently praised by clients is the bank's ability to price products rivals are no longer willing to, such as correlation swaps on single stocks. Mattatia says this is because the bank is confident its traders and sales staff will be able to recycle the inventory acquired when selling the products – a risk most rivals can't afford to take, he claims.

"If you have a limited inventory, you take a huge risk when you do that. If I sell you a basket, I'll sell you some correlation too. But if this is my only trade, I won't buy back correlation through a swap, because if the market moves a lot, the product I sold you will lose all of its correlation sensitivity. That means I've created an imbalance in my book. But when you have a huge inventory, you can be certain that – even if the market moves and some correlation vanishes – because you trade a lot of products across a range of strikes across the market, some sensitivity will reappear," says Mattatia.

Escoffier says the rationale was the same when the bank continued quoting variance swaps through the darkest days of the crisis in 2008, after rivals had withdrawn in the face of significant losses. "We lost some money at various points on the back of some bizarre market moves, but in the grand scheme of things it was minimal. We carried on because we were confident in how to go about hedging them," he says.

While clients of all stripes are quick to praise the consistency of SG's pricing, many agree it's rare for the bank to be the most aggressive. There's a straightforward explanation for that, says Escoffier.

"It's not unusual, particularly in a bull market or where you get a new entrant who's looking to shine, for a dealer to start selling risk at zero. Suddenly, a client will come to us saying our price is no good. We always tell all our clients, from the start: it's easy to make a price when the going is good; our motivation is to provide the best service, rain or shine, but not necessarily the best price, otherwise we'll be out of business. One of the good things about the current market environment is that clients are starting to fully recognise this: consistency, high levels of service and quality advisory are key." **R**

Photo: Scott Williams

"When clients know they can come to you when markets start tumbling, it creates a virtuous cycle; you get to see most of the flows, so you have a better perception of what's happening in the market"
Stéphane Mattatia, Societe Generale

Risk Awards 2015

Risk solutions house of the year

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**

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