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Risk Awards 2014

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Structured Products House of the Year

SOCIETE GENERALE
Corporate & Investment Banking

Risk Awards 2014

A brave new world

Derivatives users had a lot on their plate last year with the rollout of new Dodd-Frank rules on clearing, reporting and trading. Firms have had to adapt to the new reality – and some have been more successful than others. This year's *Risk* awards recognise those that have made the most progress. By Lukas Becker, Matt Cameron, Laurie Carver, Clive Davidson, Kris Devasabai, Peter Madigan, Fiona Maxwell, Tom Osborn, Joe Rennison, Cécile Sourbes and Duncan Wood

Many US derivatives users were very much looking forward to the September 2 Labor Day holiday. The previous few months had been a blur of activity as the first US clearing mandates came into force, starting with the largest swap dealers in March and followed by the deadline many were concerned about – clearing for large end-users on June 10. Aside from a few technical glitches, those first mandates went relatively smoothly. Another deadline was looming on September 9 for smaller, less-frequent derivatives users, but many participants were relatively confident and relaxed, and looking forward to the long weekend.

Then came the release of long-awaited rules on uncleared derivatives margining requirements on the Monday holiday, drawn up by a group led by the Basel Committee on Banking Supervision and International Organization of Securities Commissions. For some participants, it meant immediately booting up the laptop or heading into the office to analyse what the rules would mean.

That pretty much summed up the year. With so many lengthy, complex rules being finalised by global and domestic regulatory bodies, and so many new requirements coming into force, participants risked falling hopelessly behind if they spent more than a few days out of the office.

For many banks, last year was all about getting ready for new regulations – and helping their clients through the process too. That doesn't just mean helping them understand the rules and providing clearing and execution services, though. Many end-users were growing increasingly worried about contingent liquidity risks posed by sudden, large margin calls, leading some banks to focus on developing new, innovative structures that would help alleviate the impact of a cash drain. Others worked to restructure outstanding trades that would be too capital-intensive in the new world, with the aim of optimising their own portfolios and, in theory, reducing costs for their customers. Many of the most successful firms are featured in the following pages.

As always, the winners were incredibly difficult to pick. *Risk* asked candidates to submit detailed information on their businesses, and the shortlisted firms underwent several in-depth, face-to-face interviews with the editorial team. Demonstrations of key risk and trading systems were given, and calls were made to end-users and other market participants to obtain feedback. The entire process took about three months. *Risk* would like to thank all those who participated for their time.

In making the final decisions, a number of factors were considered, including (but not limited to) risk management, customer satisfaction, responsiveness to new regulations, engagement with regulators, liquidity provision and creativity. **R**

The roll of honour

Derivatives house of the year
HSBC

Lifetime achievement
Wilson Ervin, Credit Suisse

Deal of the year
Arqiva/HSBC

Bank risk manager of the year
Deutsche Bank

Interest rate derivatives house of the year
Goldman Sachs

Currency derivatives house of the year
Bank of America Merrill Lynch

Equity derivatives house of the year
Morgan Stanley

Credit derivatives house of the year
Credit Suisse

OTC client clearing service of the year
Barclays

Structured products house of the year
Société Générale Corporate & Investment Banking

Inflation derivatives house of the year
Barclays

Hedge fund derivatives house of the year
Deutsche Asset and Wealth Management

Credit portfolio manager of the year
HSBC

EM dealer of the year
Standard Bank

OTC trading platform of the year
Tradeweb

OTC infrastructure service of the year
eClerx

Derivatives exchange of the year
Ice

Clearing house of the year
LCH.Clearnet

Law firm of the year
Davis Polk & Wardwell

Corporate risk manager of the year
Microsoft

Sovereign of the year
Riksgälden

Insurance risk manager of the year
Axa

Hedge fund of the year
Chenavari Investment Managers

Pension fund risk manager of the year
PKA

Quant of the year
Michael Pykhtin

Risk management system of the year (bank)
Barclays

Risk management system of the year (vendor)
Markit IRM

Trading technology product of the year
Nasdaq OMX

Back-office technology product of the year
SmartStream

In-house system of the year
Royal Bank of Scotland

Risk Awards 2014

Structured products house of the year

Société Générale Corporate & Investment Banking

The structured products business is increasingly run on an industrial scale, with the biggest players issuing thousands of notes a year and raising billions of dollars in funding – all of it supported by state-of-the-art technology and the ability to recycle risk in chunks to hedge funds and other investors. Like a number of rival dealers, Société Générale Corporate & Investment Banking (SG CIB) can do all of that, but it wins this year's award for what might be seen as more traditional virtues – market knowledge, customer service and useful innovation.

The first two of those qualities were displayed in work with Belgium-based Belfius Bank, the successor institution to now-defunct Dexia Bank Belgium, which was bought by the Belgian government in 2011. Although Dexia may be gone, its legacy positions are not and in late 2012, tough new capital requirements for securitised assets prompted Belfius to explore clean-up options. The advisory mandate was won by SG CIB.

"Belfius gave out a tender offer for advisers to assist them in finding some solutions to optimise their capital. We won the mandate, we started analysing some of their positions and we came up with a number of solutions – several of which they implemented, resulting in the optimisation of their capital in October 2012," says Marc El-Asmar, global head of sales for cross-asset solutions at SG CIB in London.

One of the things the French bank suggested was the disposal of two chunks of securitised debt, the first backed by student loans and rated BB, while the second referenced a type of US insurance security known as a XXX securitisation, which bore a C rating. Getting rid of the positions might sound simple, but with neither type of instrument trading publicly, Belfius needed help to value the assets, identify potential buyers and arrange the sale.

"What prompted Belfius to select SG CIB was the way the bank approached the sale. These are complex positions – they were not being quoted on Bloomberg – which meant the bank really had to get out there and explain to the investors what these products were, where they came from and the valuation model being used," says a source with knowledge of the transaction.

But the information could not be broadcast far and wide. Belfius wanted to keep the transaction quiet, so SG CIB arranged a private auction, after sounding out a small number of potential buyers. "Belfius did not want too many market participants to know about the sale, so we only approached clients we knew would have a strong interest. We approached 15 clients, real-money or hedge funds, where we knew there was possible interest in the two positions," says El-Asmar.

"The achievement in the trade was in structuring a contract that managed on one side to balance what Sareb was able to post in terms of an independent amount, while on the other, successfully providing the necessary protections that the syndicated banks were requesting in order to mitigate their credit risk"
Hubert Le Liepvre, SG CIB

It worked out well for everyone involved. But not before one bank sought to bypass the auction at the eleventh hour – approaching Belfius directly with what it thought would be an attractive bid. SG CIB was confident the auction would produce a higher price for Belfius and urged the Belgian bank to stay the course. That proved to be sound advice. The assets eventually attracted a bid somewhere north of $800 million, at a higher level than the reserve price Belfius had set – and significantly above the sum offered by the competitor bank.

"These two assets were initially credit derivatives positions that were unwound and Belfius received the underlying bonds in exchange. It was the counterparty institution on those original derivatives positions that approached the bank directly at the moment of the auction, with what it claimed would be a very aggressive bid. In fact, its bid was miles away. SG CIB was able to achieve a price some points above the minimum reserve price discussed," says the source.

"Fortunately, the client was not ready to go with that counterpart and we ended up executing for it," says SG CIB's El-Asmar. "We achieved a price for both positions that was above the reserve price, the client was very happy about the quality of the execution, very happy about the fact it was done with a limited number of accounts in a very discreet manner, and while achieving a price beyond their expectations."

Another happy client was Sociedad de Gestión de Activos procedentes de la Reestructuración Bancaria (Sareb) – a special-purpose entity created by the Spanish government in August 2012 to dispose of non-performing real estate assets bought from domestic lenders. It has been given 15 years to liquidate a €55 billion portfolio, 70% of which is made up of loans to real-estate projects, with the remaining 30% taking the form of bricks and mortar.

"To buy the assets, Sareb issued bonds guaranteed by the Spanish government. The value of the floating-rate bonds we have issued is about €52 billion, which will pay investors three-month Euribor on a quarterly basis for the next 15 years," says Roberto Knop Muszynski, chief risk officer at Sareb in Madrid.

"We plan to amortise those bonds as we sell the assets until we have none of the bonds left in 15 years, but this obviously means we have huge exposure to three-month Euribor. As such, we need to hedge part of the bond portfolio, and for the first year of the amortising schedule, we needed to hedge €42 billion of the assets," he adds.

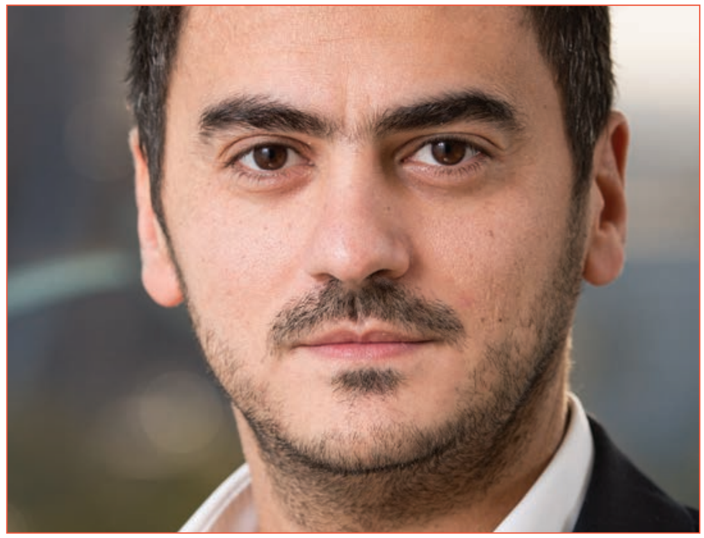
Sareb selected SG CIB and Banco Santander as the two lead managers to put in place one of the largest interest rate hedges in history over the course of two weeks in July and August last year. The hedge position was accumulated piecemeal on alternating days, with Santander executing a €5 billion position one day, for example, while SG CIB would put on a €3 billion trade the next day, allowing the two banks to build up the mammoth position without moving the market.

The hedge is a chain of forward-starting swaps of one-year maturities. When the first swap terminates on December 31, 2014, the next swap in the sequence will take effect – and so on, for the 10-year tenor of the hedge.

The position was executed in two pieces, tied to two tranches of legacy assets inherited by Sareb. The first tranche of €35 billion in real-estate assets was acquired from a group of five nationalised Spanish banks in December 2012, while assets worth €15 billion from a second group of four Spanish banks were funneled into Sareb in February 2013.

Santander placed €30 billion of the hedge relating to the December 2012 tranche, while SG CIB took the remaining €12 billion of the deal pertaining to the second portfolio of assets. Altogether, the combined €42 billion hedge represented about 80% of the overall value of the legacy assets in question.

For the SG CIB structured products team, getting the interest rate swap in place was the easiest part of the transaction. The major difficulty lay in finding other dealers to join the syndicate and agree to be long-term hedge providers to Sareb. "The real challenge was how to mitigate the credit risk associated with the counterparty, because clearly the appetite for Spanish credit risk of this size is very limited. SG CIB needed to design documentation that gave some comfort to the swap providers on this trade, so it was a balancing act between advising Sareb on how to design the swap to



Marc El-Asmar, SG CIB

ensure there would be interest from swap providers, while also ensuring the swap would match Sareb's assets and liabilities management on the performance of the underlying distressed real-estate assets," says Hubert Le Liepvre, global head of financial engineering at cross-asset solutions at SG CIB in London.

The solution was for Sareb to sign a bilateral credit support annex and agree to stump up €250 million in initial margin, giving prospective counterparties a good collateral buffer.

"No additional margin payments would have to be made unless the mark-to-market goes up or down by a bigger sum than €250 million – and that is for the whole life of the deal," says Sareb's Muszynski. "This protects us and protects the bank against our risk. It also made the deal more attractive for the banks. We are a new company that is focused on selling bad assets, so we have to provide some additional protection from our side, which is what that large independent amount provides."

The approach proved effective and the aggregate €42 billion position was successfully syndicated among six bank counterparties, with SG CIB retaining a 13% stake as long-term swap counterparty to Sareb.

"The hedge was syndicated to risk-takers, and novated from SG CIB to other banks. The achievement in the trade was in structuring a contract that managed on one side to balance what Sareb was able to post in terms of an independent amount, while on the other, successfully providing the necessary protections that the syndicated banks were requesting in order to mitigate their credit risk," says Le Liepvre.

When it comes to innovation, SG CIB can point to a third deal – a €1.4 billion longevity transaction with Dutch insurer Aegon that was announced publicly on December 5. This is a business other banks have avoided in the past couple of years, citing the new capital burdens introduced by Basel III. What saved this deal was the fact that SG CIB did not have to warehouse the risk, and was instead able to pass it directly to a group of investors thanks to some structuring pixie-dust. Speaking to *Risk* in mid-2013, while the deal was still in the works, SG CIB's insurance and pensions head said capital relief was provided to Aegon via out-of-the-money index options, rather than the more traditional swap of actual versus expected longevity, but the bank declined to add more detail. **R**