Treasury Management and Portfolio Finance amid Crisis: Checklist

Since the 2008 financial crisis, collateral management and portfolio finance has become a function of elevated importance for investment managers and thus should position the industry for relative resilience in this regard.

Although the COVID-19 crisis lacks many of the bank-specific stresses that were present during the 2008 financial crisis, it is still important to apply the lessons learned then. However, in order to avoid pitfalls of the past, managers should consider additional areas of concern given the current environment and how the industry is adapting to change, yet again.

Here are some checklist items to consider when reviewing with your service providers including prime brokers.

Counterparty Risk:

Consider likelihood that a counterparty will default and what the implications of such a default would be

- ☐ Review counterparty risk management techniques
- ☐ Review Rehypothecation terms and the limits imposed on PB's
- ☐ Consider sweeping excess cash from PB's to custody accounts
- ☐ Check Credit Ratings and CDS levels for counterparties
- ☐ Review diversification among financing providers/counterparties

Liquidity:

Consider how you would manage fund outflows coupled with reduced market liquidity and negative performance

- ☐ Identify situations that require liquidity, such as fund redemptions, margin calls, interest payments, etc.
- ☐ Review availability of liquidity such as cash holdings, borrowing ability and portfolio liquidity. Consider how market events could impact these and their relative costs.
- ☐ Review and update the cash management procedures to reflect internal and external changes to areas such as authorized signatories, limits and counterparties/service providers.

Margin:

Consider how leverage can be maintained

- ☐ What rights do the brokers have to call for additional capital?
- ☐ Maintain a line of communication with counterparty's risk group, particularly when winding up/down.
- ☐ Understand margin requirements of counterparties and how they might change with increased market volatility.
- ☐ Note the stability and flexibility of margin levels/methodology during times of market stress.

Scotiabank®
GLOBAL BANKING AND MARKETS

Service Level/Operations Management:

These reflect potential ways to respond to and mitigate some of the above risks

- ☐ Valuations – document what vendors/independent agents are doing to address ambiguity
- ☐ Settlement timing – positions may need to be moved from one prime broker to another; be cognizant of how long settlements take and test/record how long the process takes.
- ☐ Verify and understand composition of financing accrual charges; months like March or April could see some large increases in financing charges. It's important to understand where these charges are coming from as there may be some gains available from reallocations/repositionings.
- ☐ Hard to borrow assets – Is there any value that the fund can extract from long positions?
- ☐ Cross currency balances - Check for financing charges on nettable balances across currencies (especially where subaccounts are used) to ensure efficiency
- ☐ Review and update BCP plans. Discuss update BCP plans of counterparties and service providers to review what they have done to enhance their backup operations.
- ☐ Staffing/Technology Levels – are they adequately staffed to accommodate working remotely?

Documentation:

Brings together the above topics

- ☐ Tri-party agreements review
- ☐ NAV triggers & ISDA agreements
- ☐ Contract notification terms - Check all clauses governing termination of an agreement. A sudden termination may adversely impact the fund; understand what terms are in place.
- ☐ Stress tests to evaluate impact on covenants, access to funding and excess reserve on balance sheet that might be needed to navigate the crisis.