INTEGRATED TREASURY – COST CENTRE AND PROFIT CENTRE

MEANING

Integrated treasury is an **approach to funding the balance sheet and deployment of funds across the domestic as well as global money and forex markets.**

FUNCTIONS OF INTEGRATED TREASURY

- **Reserve Management and Investment:**

This is an important function. It involves:

(i) Complying with CRR / SLR obligations,

(ii) Having an appropriate mix of investment portfolio to optimize yield.

- **Liquidity and Funds Management:**

It involves:

(i) Analyzing of major cash flows arising out of asset-liability transactions,

(ii) Providing a balanced and well-diversified liability base to fund the various assets in the balance sheet of the bank, and

- **Asset Liability Management:** ALM calls for determining the **optimal size and growth rate of the balance sheet and also price the assets and liabilities in accordance with prescribed guidelines.**

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- **Risk Management:** Integrated treasury manages all market risks associated with a bank's liabilities and assets. The market risk of liabilities pertains to floating interest rate risks and asset and liability mismatches. Market risk for assets can arise from:

(i) unfavorable change in interest rates,

(ii) increasing levels of disintermediation,

(iii) Securitization of assets (**the conversion of an asset, especially a loan, into marketable securities, typically for the purpose of raising cash by selling them to other investors**)

- **Transfer Pricing:** The treasury has to ensure **that the funds of the bank are deployed optimally, without sacrificing yield or liquidity**. An integrated treasury unit has an idea of the bank/s overall funding needs as well as direct access to various markets (like money market, capital market, forex market, credit market). Hence, ideally the treasury should provide benchmark rates, after assuming market risk, to various business groups and product categories about the correct business strategy to adopt.
- **Arbitrage:** Treasury units of banks undertake arbitrage by **simultaneous buying and selling of the same type of assets in two different markets in order to make profit**. Arbitrage could also help in risk management.
- **Capital Adequacy:** The Capital Adequacy Ratio set standards for banks by looking at **a bank's ability to pay liabilities, and respond to credit risks and operational risks.** A bank that has a good CAR has enough capital to absorb potential losses. Thus, it has less risk of becoming insolvent and losing depositors' money.

NATURE OF INTEGRATION

Integration of treasury can take many shapes.

- To start with, there is geographical and infrastructural integration. In **this type of integration, the forex dealing rooms are merged and located in the same premises along with the domestic treasury unit**.
- Under horizontal integration the dealing / trading rooms engaged in **the same trading activity are brought under the same policies, hierarchy, technological and accounting platform.**
- In vertical integration all existing and diverse trading and arbitrage activities are brought under one control with common pool of funding and contributions.

BENEFITS OF INTEGRATION

The basic objective of integration is to improve portfolio profitability and risk-insulation. Banking assets are held basically **for client relationship / steady income / statutory obligations and are generally held till maturity, whereas trading assets are held primarily for generating profits on short-term differences in prices / yields.**

The purpose is achieved through **efficient utilization of funds, cost effective sourcing of liability, proper transfer pricing, availing arbitrage opportunities, online and offline exchange of information between the money and forex dealers, single window service to customers, effective MIS, improved internal control, minimization of risks and better regulatory compliance.**

STRUCTURE OF INTEGRATED TREASURY

The treasury branch is manned by the **front-office, mid-office, back-office**.

- **Front Office-**The dealers and traders constitute the front-office. In the course **of their buying and selling transactions, they are the first point of interface with other participants in the market** (dealers of other banks, brokers and customers). They report to their department heads. They also interact among themselves to exploit arbitrage opportunities.
- **Mid office** -A mid-office set-up, independent of the treasury unit, acts as the **unit responsible for risk monitoring, measurement and analysis and reports directly to the top Management for control, through the Chief Risk Officer.** This unit provides risk assessment to Asset Liability Committee (ALCO) and is responsible for daily tracking of risk exposures, individually as well as collectively.
- **Back Office-** The back-office **undertakes accounting, settlement and reconciliation operations.** The audit group independently inspects / audits daily operations in the treasury department to ensure adherence to internal / regulatory systems and procedures.

ARBITRAGE BENEFIT TO TREASURY

The price differentials **between different markets of the same asset category give rise to arbitrage opportunities.**

For example, arbitrage benefit can be availed by borrowing in US dollar, converting the same into rupee, taking forward cover to hedge exchange risk and investing the same in domestic market.

What is 'Arbitrage'

Arbitrage is the **simultaneous purchase and sale of an asset to profit from a difference in the price.** It is a trade that profits by exploiting the **price differences of identical or similar financial instruments on different markets or in different forms**. Arbitrage exists as a result of market inefficiencies.