

The Investment Conundrum of Treasury Department — A Case Study on Treasury Management

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Abstract

The Case throws few practical problems on the nuances of treasury management in commercial banks and how the macroeconomic and domestic factors could influence the profitability of the domain. It introduces the various financial instruments traded by the department and the different market situations faced by the treasury professionals. The Case is prepared based on the experience gained by the author working in the similar domain and would help the students of finance domain to understand the basic framework of treasury management.

Keywords: Forex and GDP, Government Securities, Investment Summary, Treasury

1. Introduction

It was a cloudy day in Mumbai. There was continuous downpour for a week and entire Bandra Kurla Complex had merged with the Mithi river. Mr. Puneet Singhania, Executive Vice-president and Head of the treasury department, The Pan India Bank limited was having a sip of coffee and his eyes were fixed on the slums of Dharavi which was visible from the 8th floor of his office, at the Bandra Kurla Complex, the financial hub of India. The latest Q on Q results of the bank (Table 3 and Figure 2) lay scattered on his table. The results were not encouraging for his division. Bank has shown a loss of 169 crores in the June quarter ending 2021. His department has been the profit center for the bank for the last 10 years. But, the situation was not the same anymore. The Russia has started bombing Ukraine, the world was witnessing yet another unlikely event. The war has brought in uncertainty in-terms of economic and political stability.

With the debt market turning volatile and the equity market in doldrums due to war and other domestic challenges, the investment division was reporting losses

after losses for the last 4 quarters. This indeed has compelled the top management to take strict actions like layoffs and linking the salary with performance. Singhania has been called to the Head office at Delhi by the Board of Directors to make a presentation justifying the reasons for the failure of his division to perform.

Mr. Singhania, an experienced banker who had 25 years of experience in various domains of investment banking was facing the problem of not understanding the market for the first time in his career. The Front office desk was not making substantial profit, especially the Government security dealers. The Russia and Ukraine issue, Russian Rubble and stock market collapse and supply based constraints in global crude delivery have already made the market volatile, the domestic market prospects were also not looking that exciting. The government has already overshoot on the Fiscal deficit target for the financial year 2022. The 10-year yield was going up as the market players were offloading their positions by selling off G-sec. The situation of NIFTY was not different too, untamed inflation levels and RBIs push on taming inflation has paused the growth

Table 1. Investment Summary of the Treasury department of The Pan India Bank Limited

Investment Summary (in crores)					
Particulars	Q3 2021	Q4 2021	Q1 2022	Q2 2022	Q3 2022
Government Securities	7203.00	7403.00	8103.00	9803.00	13503.00
HTM	5420.00	5020.00	4620.00	4220.00	3820.00
AFS	1200.00	1650.00	2100.00	2550.00	3000.00
HFT	583.00	733.00	1383.00	3033.00	6683.00
Equity Investments	1001.23	1102.15	1203.07	1303.99	1404.91
AFS	620.00	692.00	764.00	836.00	908.00
HFT	381.23	410.15	439.07	467.99	496.91
Certificate of Deposits	3212.00	3227.00	3242.00	3257.00	3272.00
Call Borrowings	1200.00	1100.00	1330.00	1230.00	1460.00
Overnight	750.00	800.00	850.00	900.00	950.00
14 days	450.00	300.00	480.00	330.00	510.00
Reverse Repo	295.00	320.00	343.00	375.00	410.00
Forex	1289.24	1151.06	1911.47	2261.01	950.09
Spot	659.22	812.45	965.68	1118.91	200.00
Forwards	630.02	338.61	945.79	1142.10	750.09
Total	14200.47	14303.21	16132.54	18230.00	21000.00

inducing measures from the part of policy maker. The Beta level of stocks were on a higher side and NIFTY had seen a huge fall of 2000 points in last 10 trading sessions.

2. About Pan India Bank Limited

Pan India Bank Limited is one of the largest private sector banks of India; the promoters own over 49% of its

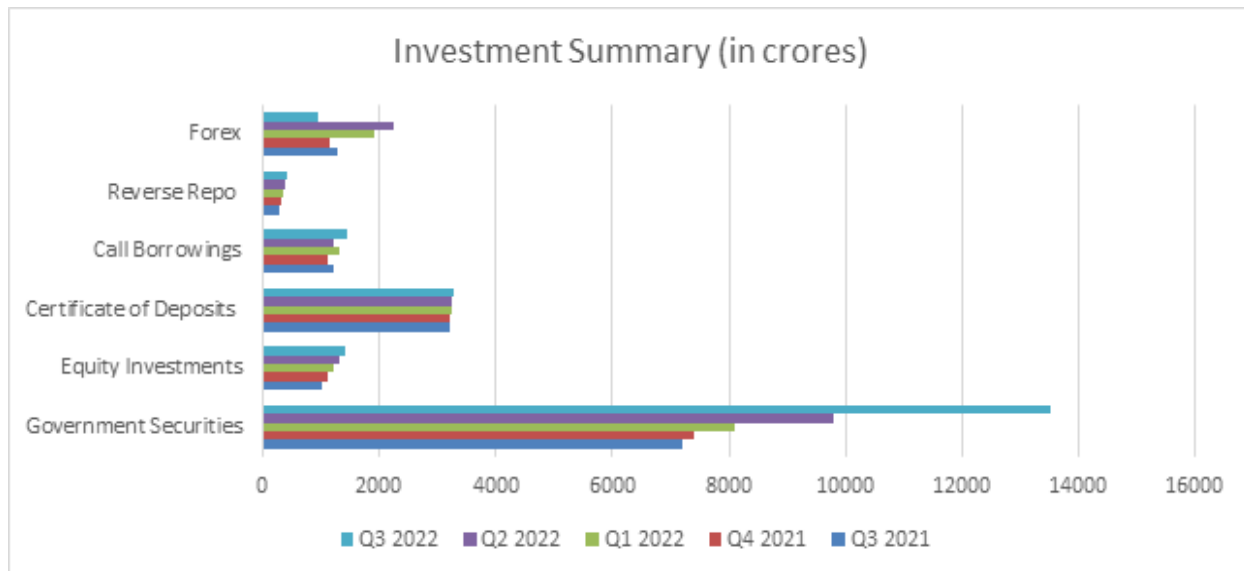


Figure 1. Investment summary of Treasury Department.

capital. It is listed on the Forbes 500, and has assets worth US\$23.45 billion. PIB has around 2,300 branches. Four of these are overseas in Hong Kong, Dubai, Antwerp, and Sydney. UBI also has representative offices at Jakarta, Beijing and Abu Dhabi. Lastly, PIB operates in the United Kingdom through its wholly owned subsidiary.

Pan India Bank expanded internationally in 2006 with the opening of offices in Sharjah, United Arab Emirates, and Shanghai in the People’s Republic of China. The next year, Pan India Bank established a branch in Hong Kong, its first branch outside India. In 2009, Pan India Bank opened a representative office in Sydney, Australia.

3. About Treasury Department

The treasury department of a bank is responsible for balancing and managing the daily cash flow and liquidity of funds within the bank. The department also manages the bank’s investments in Government securities, stocks, foreign exchange and cash instruments.

Division ensures that the bank has enough liquidity to meet its net cash payments. Cash payments represent checks drawn on customer accounts and loan outflows. The daily net liquidity is managed by either borrowing money to cover deficits from the call money market or selling money to other banks for cash flow coverages using instruments like certificate of deposits.

The treasury department is responsible for the evaluation, safety and profitability of the bank’s investment portfolio derived from excess funds not used for the origination of customer loans. Treasury manages the Statutory Liquidity Ratio (SLR) and the Cash Reserve Ratio (CRR) requirements of the Bank. Their investments range from SLR securities which are kept as a part of RBI regulation to certificate of deposits for ensuring liquidity. The treasury department manages investment assets and liquidity risk by matching them against the deposit side of the bank. The combined flow of funds and interest rates from loans and investments must exceed that of deposits for each time period analyzed. The bank is primarily generating profit from the spread which is nothing but the difference between rate at which loans are given and the rate given for deposits.

4. Government Securities Market

A Government Security (G-Sec) is a tradable instrument issued by the Central Government or the State Governments. It acknowledges the Government’s debt obligation. Such securities are short term (usually called treasury bills, with original maturities of less than one year) or long term (usually called Government bonds or dated securities with original maturity of one year or more). In India, the Central Government issues both,

treasury bills and bonds or dated securities while the State Governments issue only bonds or dated securities, which are called the State Development Loans (SDLs). G-Secs carry practically no risk of default and, hence, are called risk-free gilt-edged instruments. The mandatory requirement of SLR maintenance makes this market liquid and the demand of Government securities more or less stable.

5. Held to Maturity (HTM)

Held to Maturity investments are investments made by the bank which it intends to hold till maturity. Only debt securities can be categorized as HTM because they have a definite maturity. A HTM investment needs to be reported on balance sheet at its amortized cost. Banks can shift the investment from HTM category with the approval of the Board of Directors once a year. Such shifting will normally be allowed at the beginning of the accounting year. No further shifting to/from this category will be allowed during the remaining part of that accounting year.

6. Available for Sale (AFS)

Available for Sale portfolios have debt securities that are bought into the portfolio with the intention to sell before reaching the maturity. Banks have the freedom to decide on the extent of investment under AFS category. Investment made under AFS category will be marked to market at quarterly or at more frequent intervals. The net

depreciation under this category should be recognized and the net appreciation under these if any, should be ignored.

7. Held for Trading (HFT)

Held for Trading investment are financial assets that are held with the sole intent of generating short term profits. HFT investments are reported at its fair value on the balance sheet and any change in any the value of investment or dividend and interest income received during the period of holding will be reported in the profit and loss statement.

The securities under HFT category have to be sold within 90 days of investment. If the bank is not able to sell the security within 90 days due to exceptional circumstances such as tight liquidity conditions or extreme volatility or market becoming unidirectional, the security should be shifted to the Available for Sale category.

The latest quarter reported the investment activities worth 21000 crores (Table 1) and a loss of 564.51 crores (Table 2) from the treasury department alone.

“Beep Beep” sound from the terminal broke the chain of Mr. Singhania’s thoughts. The tickers in the Bloomberg terminal showed.

- The Finance Ministers decision to ease the corporate tax burden on the companies before September 2022.

Table 2. Profit split up of various divisions of The Pan India Bank Limited

Particulars	Q3 2021	Q4 2021	Q1 2022	Q2 2022	Q3 2022
	(in crores)	(in crores)	(in crores)	(in crores)	(in crores)
PBT					
Retail	123.50	143.50	163.50	183.50	203.50
Corporate	111.50	131.50	151.50	171.50	191.50
Treasury Operations	135.49	35.49	-164.51	-364.51	-564.51
Total	370.49	310.49	150.49	-9.51	-169.51

Table 3. Profit split up of Treasury Division

Particulars	Q3 2021	Q4 2021	Q1 2022	Q2 2022	Q3 2022
	(in crores)	(in crores)	(in crores)	(in crores)	(in crores)
PBT					
Equity	24.99	9.53	-10.33	-120.52	-199.00
Government Securities	71.20	27.44	-99.92	-201.70	-304.27
Forex	39.30	-1.48	-54.26	-42.29	-61.24
Total	135.49	35.49	-164.51	-364.51	-564.51

Table 4. Marked to market split up of Government Securities Trade

Particulars	Q3 2021	Q4 2021	Q1 2022	Q2 2022	Q3 2022
	(in crores)	(in crores)	(in crores)	(in crores)	(in crores)
MTM profit/Loss					
Held till Maturity(HTM)	25.18	12.36	75.00	65.00	60.34
Available for Sale(AFS)	43.23	13.46	-39.48	-100.00	-200.58
Held for Trade(HFT)	2.79	1.62	-135.44	-166.70	-164.03
Total	71.20	27.44	-99.92	-201.70	-304.27

Table 5. Forex split up

Profit	Q3 2021	Q4 2021	Q1 2022	Q2 2022	Q3 2022
	(in crores)	(in crores)	(in crores)	(in crores)	(in crores)
Spot Market					
USD/INR	36.45	12.33	1.54	9.95	8.54
EUR/INR	12.33	5.31	4.23	-0.84	1.56
EUR/GBP	-2.65	-6.54	-2.35	-5.32	-4.32
Total	46.13	11.10	3.43	3.80	5.78
Futures and Forwards	-6.83	-12.58	-57.69	-46.09	-67.02
Total	39.30	-1.48	-54.26	-42.29	-61.24

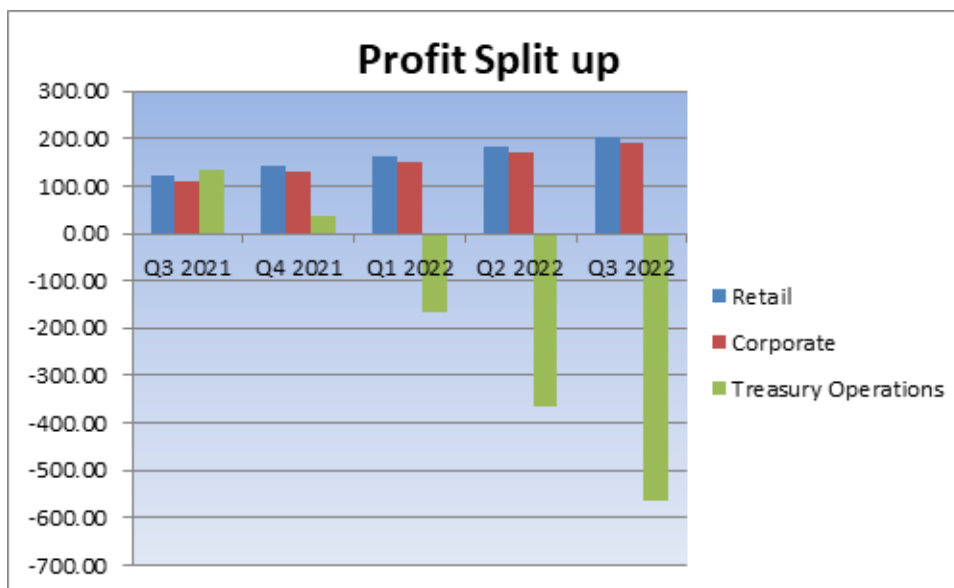


Figure 2. Profit split up of Pan India Bank Limited for the last 5 quarters.

- FII investments in the equity segment rose by 15% for the fourth quarter of financial year 2021–22.
- GDP growth forecast was to be published by next week and Bloomberg survey showed 10 out of 12 economists voting for 7% growth in the fourth quarter of 2021 against a mere 5.2% in the last financial year.
- In order to stabilize the G-sec market, RBI has permitted a onetime shifting of government securities from AFS to HTM. The HTM securities need not be marked to market, i.e., depreciation need not be charged in the profit and loss account of the banks.
- The Russia-Ukraine episode has resulted in the expectation that IT companies would shift their support service base from Europe to India in the short-run.

Mr. Singhania had a smile on his face now and knew that the continuous rain over Mumbai city has washed away his division's misfortune and his department is ready to roar now. He immediately typed a mail to Mr. Vivek Dahiya, the CEO of Pan India Bank Limited which stated that he is ready with a concrete plan for bringing back the glory of his department by making the division a profit center by quarter 1 of Financial Year 2022-23.

The intercom rang and the call was from Ms. Megha Philip, Manager HR informing about the sanctioning of

5 lakh rupees for the training programme in technical analysis for the dealers at NISM, Pune. It was 7 pm in the evening, the back office head came to him with investment summary of the day but, Mr. Singhania was busy shortlisting his front office dealers for the training programme.

6. Questions

1. Frame out a concrete plan for making Pan India bank's treasury department a profit center.
2. Throw light on the possible end results if the information given in the form of tickers by the Bloomberg terminal turns out to be cent percent accurate?

7. Teaching Notes

Overview

This case is a clear cut example of how the treasury department works based on the experience gained by the author who was working in the same area. Case discusses about the basic functions of the treasury department of commercial banks. It also throws light on the basic financial instruments traded by the division. The case tries to point out that the market basically moves based

on information. Information supplied towards the end of the case (as tickers in Bloomberg terminal) should be taken as a cue for making investment decisions.

Application

This case is appropriate for MBA/PGDM students having Finance as major specialization as a part of their Security Analysis and Portfolio Management Course. The prerequisite from the part of students are:

1. Students are to have a good command on the basics of Security Analysis and Portfolio Management Course. It's better to discuss this case towards the end of SAPM course.
2. The students should track the latest developments of the market and should be aware about the basics of investment.
3. They should have a good understanding about the monetary policies of RBI.

Objectives of the Case

Type of Case: Complex

This case aims at making the student understand the practical aspects of treasury management as this area remains a niche segment in finance. Ample opportunities and immense scope in this area makes the reading interesting for the students. The case discusses about the ever changing nature of the market and strategies to be

churned to face the volatility. After the case discussion, the students should be able to have a basic understanding on the following aspects.

- Functions of Treasury Management.
- Various categorization of investments
- Income sources of a Bank.
- Various investment split-ups of treasury department
- Importance of market information.

Teaching Suggestions

The class has to be provided with a good background understanding about different types of the investments. A discussion on the various financial instruments used in the Indian Financial system will serve the purpose. Faculty can bring a person who is a professional in treasury management for better results. Projects like tracking the NIFTY index or 10-year G-sec, etc. can sustain their interest towards this niche segment.

Additionally, students should be encouraged to do certain online courses related to treasury management or investment banking.

8. References

1. *Indian Institute of Banking and Finance*. (2010). Treasury Management, Macmillan Publications.
2. Frequently Asked Questions by RBI-m.rbi.org.in/Scripts