Innovation Award: "Interest rate policy, what impact?"

In summer 2009, CIB developed a new methodology for analysing one of the key corporate questions: optimal fixed-floating mix and duration and how it impacts the share price. CIB won an Innovation Award in the 'Products and Services' category for this project. To talk about it, we are today with Stanley Myint, Head of the Portfolio Optimisation team for CIB. Hello and welcome!

Stanley Myint, could you introduce the "Interest rate policy, what impact?" project?

Of course. Prior to the credit crisis, many traditional corporations opted for a conservative fixed-rate policy with a high proportion of fixed-rate debt. But crisis can be a powerful catalyst of change. In today's difficult environment, many companies are looking for ways to optimize their financial structure, and interest rate policy is part of that. More floating interest rate policy impacts the corporate valuation in two ways: positive impact means reduction in WACC [weighted average cost of capital] through lower interest costs, while the negative impact means an increase in WACC to higher equity risk premium. For investment-grade companies with significant debt, we find that the positive impact outweighs the negative one. We analysed about 13 large European companies with a cumulative market capitalisation of 400 billion euros and presented our results to them. Generally, our approach was considered as original and valuable, and it radically changes the way that companies manage their interest rate risk.

What is the originality of this project?

My team "Corporate Solutions Group", which is part of Fixed Income, always starts with a client issue, to which we add our, experience and ideas. This project started from a question asked by the CFO of Deutsche Telecom. So we really had to think out of the box in order to answer it. In academic literature, there are plenty of references to the optimal capital structure and its impact on valuation. But to my knowledge, no one before has looked at the impact of interest rate policy on valuation.

What are the benefits for the customers and for BNP Paribas?

Well, clients should immediately notice a lower, albeit more volatile interest score, than before. All the time, their valuation relative to peers should improve in line with a new more efficient balance sheet. On our side, we expect increased business from restructuring of existing portfolios and from future bond swaps into floating. And we also expect to be invited, to give all sorts of other key strategic issues for the client.