Risk

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Limits of understanding

Soon, banks will no longer be banks. Take for example Banca Commerciale Italia (BCI). Its New York branch now has more exposure to US corporate names through its credit derivative positions than it has through loans on its balance sheet. Francesco Caputo Nassetti, BCI's head of capital markets, says that buying credit derivative exposure is now a real strategic alternative to the cost of setting up a branch network in new markets for BCI. The trade-off is the loss of long-term client relationships. Credit derivatives don't bring those. But a bank such as BCI – with branches in 41 countries – can certainly afford to weigh the relative advantage of synthetic exposure against the returns of a physical presence.

The distinctions are becoming blurred on the other side of the buy-sell fence too. The changing membership of the International Swaps and Derivatives Association is a fair illustration of the trend for the largest and most sophisticated corporate users of derivatives to become dealers. Isda now has 120 subscriber members – corporate, sovereign and supranational end-users of derivatives. That's fewer than the association's 208 primary members – the dealers – but the gap will continue to narrow. More end-users are joining Isda all the time. In particular, energy companies are joining as dealers as well as users of derivatives – in total 13 of them joined Isda over the past year.

MATTHEW CRABBE
Editor

But some relationships are not changing so quickly, as our cover story this month reveals. Gold production companies are having to dramatically rethink their hedging strategies, partly because – in the wake of the Ashanti Goldfields debacle – the stock market has started to reward them for not hedging. One conclusion that can be drawn is that investors still don't know enough about derivatives to trust them. That has corporate governance implications that stretch well beyond the gold business. The story starts on page 20.

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BCI-CABOTO: THE GAME STARTS

The lack of official declarations and a bog show of diplomacy can hardly mask the behind-the-scenes battle taking place between Caboto and BCI's capital markets division. As a matter of fact, BCI, at least until the end of 1999, tried to power up its capital markets capacity in an attempt to increase its bargaining power with Banca Intesa's capital markets arm, Caboto, headed by Fabio Arpe. The timing was obvious. With the BCI-Intesa deal no longer in the headlines, in January, the two banks began with merger of their operating structures. On one side of the scale, Caboto has placed the volumes it realized on both primary and secondary markets in1999. BCI, on the other hand, comes to the merger with a much stronger international presence. Both Marco Cerrina Feroni, head of BCI's equity division, and CFO Alberto Varisco, had shopped around at various institutions in order to recruit talented people and thus secure the bargaining power they needed at the negotiating table. For instance, two specialists of credit derivatives moved from Citibank to BCI at end 1999. Though a seemingly rather brave decision at a first glance, BCI is a European leader in credit derivatives, under Francesco Caputo's guidance. Consultants at work on the merger, McKinsey and Boston Consulting Group, are reportedly still undecided on the criteria to adopt in order to carry forward the merger, and respective positions vary widely depending on the criteria used. One measuring stick will be the volume of activity done on capital markets, in other words, specialization by product, in 1999. From this perspective, Caboto largely prevails (see table). But if specialization by customer is taken into account, BCI has stronger franchise on large corporate customers. Hence it is uncertain whether it will be BCI to be conferred Caboto's corporate finance business, or whether it will be Caboto to be conferred BCI's primary issuance capabilities.

Consultants are currently laying down the cards on the table, i.e. they are defining the profiles and track records of the key people from both institutions.

In the meantime, Caboto's CEO Fabio Arpe is rumoured to have cancelled a meeting with his key people that he had scheduled for the outset of February to present the synergies of the merger. Is it still too soon to sing victory?

CABOTO VS. BCI IN 1999

DEBT ISSUANCE	
EUR bn	Amt
CABOTO	37,5
BCI	2,2
EQUITY ISSUANCE	
BCI	31,9
CABOTO	22,3

SOURCE: CAPITAL DATA BONDWARE