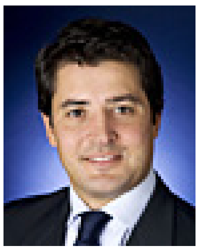
Deutsche Bank
Global Transaction Banking

TreasuryPulse

Passion to Perform

Bilateral Standby Letter of Credit Facility Can Free Up Working Capital



By
Alfredo Parra
Sales Manager, Trade Finance & Cash Management Corporates
alfredo.parra@db.com

The global financial crisis spawned a couple trends that are combining to put a squeeze on many large corporate financing efforts. First, many corporations have seen their bank syndicates reduce the size of their revolving credit facilities. And, second, their need for standby letters of credit (LCs) to mitigate risk in a variety of transactions has grown. This has put corporations in a pinch, since they typically use their revolving credit loans both to access working capital and to back their standby LCs.

To illustrate, consider a corporation that prior to 2008 had a $5 billion revolving credit loan through a syndicate of 30 banks. The corporation uses its revolver both for daily cash needs and as a contingency facility for standby LCs. But when the financial crisis arrived, credit conditions tightened and its bank syndicate cut its facility to $3 billion. Going forward, this company faces a challenge: How is it going to meet both its working capital and standby LC needs with its reduced credit facility?

One emerging solution comes from banks like Deutsche Bank that are willing to extend bilateral facilities dedicated to supporting a client's standby LCs.

For example, the company described above could maintain its $3 billion revolving credit loan with the bank syndicate but consider moving its standby LC business to a single bank offering, say, a $1 billion bilateral facility for standby LCs. This maneuver would enable the company to utilize the entire $3 billion revolver for cash needs and still issue the standby LCs its business partners require.

Bilateral Facility Benefits

In addition to freeing up much needed working capital for daily cash needs, a bilateral facility enables a corporation to consolidate its total exposure with one bank and provides a convenient, single point of entry for submitting all of its standby LC business.

Other benefits of a bilateral facility include unified pricing and reporting.

When moving to a bilateral facility for standbys, corporations also are afforded an opportunity to "clean up" their standby LC portfolios. Some companies have as many as 1,000 or more standby LCs, with some in place for 10 years or more. Moving their standby LCs to one institution enables them to review their entire portfolio and eliminate unnecessary LCs — for instance, when the contracts the instruments back have expired — and update other LCs to meet revised contract amounts.

It's Not That Complicated

Often, a corporation like the one we highlighted above will have four or five of its syndicate banks responsible for issuing its LCs. While moving all of the company's LC business to one bank has many benefits, it is not an automatic process.

Some of the tasks in moving a portfolio of LCs to one institution include communicating with LC beneficiaries about the change and making terms and conditions amendments to the new LCs where necessary. For companies with extensive standby portfolios, the task may seem daunting. But it's really not that complicated if they move their LC business to a bank with a strong operations team and lean on that team for migration assistance.

Companies that conduct business globally should select a global bank for their standby LC business. A supplier in China, for instance, will always want the standby LC that guarantees payment to be issued in China. If your company's bank has a presence in China, that will give you more control and usually better pricing than if you rely on the correspondent of a U.S. bank to issue the LC.

When transitioning to a bilateral facility for standby LCs, it's also important to outline and communicate a clear transition strategy. Make sure the bank providing your bilateral facility and your staff understand the time frame for the transition and the steps along the way.

Standby LC Advantages

Finding additional credit capacity to support standby LCs is critical for many companies because standbys are in such great demand today. In the wake of the financial crisis, companies remain less certain about the financial stability of even companies they have been doing business with for years, requiring additional risk mitigation in commercial contracts.

Standby LCs are often viewed as preferable to putting up cash or escrow funds to protect against a counterparty default, and they are also much simpler to use than commercial LCs, which require extensive documentation.

If your corporation has a strong appetite for standby LCs and is feeling a working capital pinch due to diminished limits on your revolving credit loan, talk to your Deutsche Bank representative about a bilateral facility for standby LCs. This emerging alternative can both free up more cash for your business and streamline your contingency facilities.