{ TREASURY INSIDER }

To cash back or not cash back?

Inviting relationship banks to compete on ancillary business seems like a good idea – until you actually go ahead

I was called into a meeting with our head of insurance, head of tax and the CFO the other day. I thought: this must be serious.

They have had a great idea, and want to respond to ever-increasing insurance premium tax rates – 10% is now on the horizon. The CFO is concerned that the group is paying out too much in insurance premiums and mounting tax is adding to this cost. They asked whether we can consider forming a captive insurance company and manage the cost and cash more effectively by self-insuring.

It sounded a good project and I was enthusiastic about joining this project team. Secretly I was hoping that the new captive would be formed in a glamorous location and I may be asked to be a director, but I wasn't going to play that card... yet.

The specific question for me was whether it was cost-effective for there to be a full-market risk transfer via the captive. If not, there would need to be some collateral provided. In that scenario, there was a further choice. Whether to cash back or not to cash back?

This came at an interesting time, as the collateral would usually be in the form of letters of credit (LCs) and might be a chance for banks to compete for some ancillary business. They keep saying we offer too little to them, after all. Given the number of times I have had trade finance teams offer products we don't need, this seemed like a good opportunity to see if we get a positive response when we make an enquiry.

SHUTTERSTOCK

Backing these lines with cash was virtually risk-free for banks

I asked which banks among our syndicate offered these lines and received a bit of a mixed response. Even more so when I said that we'd like to know if they could be extended without cash backing, which would give rise to a higher level of fees. Some went as far as to say they'd need to get specific credit approval from the next credit committee meeting in a few months' time, which surprised me given recent discussions. In fact, this appeared from my networking to be a fairly standard offering. I gave my views to the relationship managers privately!

This turns out to be one of those strange occasions when you think that banks would be keen to take up ancillary opportunities, but there was less enthusiasm than I expected.

I realised that backing these lines with cash was, of course, virtually risk-free for banks, so I was surprised at the level of uncertainty and also at the proposed cost. It was almost better value to seek uncollateralised funding and keep flexibility. That option seemed to go down better with the CFO anyway.

There followed even more interesting discussion with the insurers, whose views on bank creditworthiness differed somewhat from what we might have expected, and from the offerings from our syndicate of banks. They clearly had their own limits on individual banks. Insurers' credit officers are now another counterparty we need to meet with more regularly.

What we ended up with was an even more complex matrix of cost, relationships and practicalities. Negotiating LC facility and indemnity agreements was not straightforward either.

Ultimately, it was good ancillary business for some banks and we chose not to cash back as, had we done so, we would have tied up almost as much cash as we would have had we stayed with paying premiums, but without actually benefiting from full-risk transfer.

This arrangement does place more onus on the company to meet high-risk management standards, which is in keeping with our public profile, so this all aligns to our business strategy and should save cost all-in if claims are low.

I did get asked to be a director of the captive. But I'm not envisaging the need to stock up on sunblock soon.

The Treasury Insider has led corporate treasury functions inside a well-known company