Introduction

Trade credit insurance in the U.S. continues on a rapid growth curve as credit executives embrace is use to reduce risks associated with domestic, export and international sales. Europe continues to register the highest market penetration of trade credit coverage overall with use and demand rising quickly in Asia and the Middle East as well.

Since 2010, the use of credit insurance has grown exponentially while the use of less-efficient credit methods, specifically letters of credit continue to diminish. The trade credit insurance market in North America has been estimated in the $700+ million range in annual premiums

This coverage serves as a strategic management tool by protecting policyholders from commercial accounts receivable losses following a customer's bankruptcy or payment default, or events in overseas markets such as political turmoil or import and trade restrictions. Policies are available to cover domestic receivables, export receivables or both.

Businesses make use of trade credit insurance to reduce debt concentration risk, obtain better financing terms and strengthen global credit management procedures. Trade credit insurance also helps policyholders compete more effectively. Credit terms offered to customers have become an important component of competitive strategy. Credit insurance allows policyholders to gain competitive advantages through extended open terms, aggressive credit limit values and expansion into emerging markets.

Reducing Debt Concentration Risk

Industry consolidations in pharmaceuticals, food products, retail, commodities and other key sectors have exposed some businesses to significant financial risks. Companies are unable to set sufficient bad-debt reserves to cover a default by one of the major players in these industries. In very high-concentrations, where one buyer might represent 20 to 30 percent of sales or more, it doesn't make accounting sense to set reserves at the level otherwise called for based on the size of the receivables. Some financial executives are simply avoiding the issue, whilst more proactive credit professionals have found commercial credit insurance offers a cost effective solution.

Underwriting trends have exhibited a lowered of premiums substantially from even just a few years ago. The credit insurance market is populated with new and innovative underwriters bringing forth additional capacities and new policy formats. For example, underwriters are now able to issue very high credit limits in key buyer situations, which are often high-quality risks that simply represent high levels of debt concentration. Together these factors give the insurer and the policyholder the flexibility to collaborate and tailor the coverage terms and premium in a way that makes clear financial sense. It's common for the policy to pay for itself through the increased sales made possible by the coverage. The motivation to insure major credit concentrations stems not only from the need to protect against loss. Sarbanes-Oxley requires that public companies report these exposures on their 10Qs, so the reserves shortfall are open and transparent. Reducing the possibility of a shareholders' lawsuit over leaving the company's largest risk uninsured is an added policy bonus.

Foreign Trade Credit Enhancement

Banks traditionally don't lend against foreign receivables because they don't have an efficient way to credit-qualify their borrowers' customers. Exporters selling on open account terms cope with the fact that international sales and the ensuing receivables deplete cash. Recent surveys suggest that three quarters of exports are made on open account terms with an average days-sales-outstanding (DSO) ratio of 75 days. This compares with an average of about 40 days for domestic sales.

Although transactions done via letter of credit are declining due to the emergence of more efficient technologies, exporters selling on letter-of-credit terms, even if they offered 90 or 180 days for payment, ordinarily can discount the receivables and receive immediate cash. Foreign open accounts receivable are not as easy to discount. Exporters often wind up with huge amounts of working capital tied up in foreign receivables and can't borrow against them.

Many banks are now advising customers to purchase credit insurance on international receivables. **With credit insurance, the banks can include otherwise ineligible foreign receivables in a customer's borrowing base.** And if the exporter sells its foreign receivables, it can often get an accounting opinion that allows it to take them off the books, resulting in unencumbered cash and major improvements in DSO.

Companies insuring their foreign receivables can also realize a number of significant competitive advantages. For example, they may be able to safely expand more aggressively than competitors into new markets where good credit information on prospective customers is often hard to obtain. Credit insurance can also help an exporter become a preferred vendor for more foreign buyers by enabling those buyers to eliminate the significant time, effort and expense involved with letters of credit, and by offering better credit terms than competitors, without added risk.

Improved Financing Terms

Credit professionals are leveraging this protection with domestic receivables as well to provides its lenders with the security of insured accounts receivable collateral to support better financing options and expand borrowing power. This elevates a relatively messy asset class into an investment-grade-rated asset pool, enabling the bank to increase advance rates and get additional security while staying within individual borrower risk limits. The policyholder is thus able to receive additional working capital, while the bank enjoys the benefits of a more satisfied borrower and, often, increased return on capital.

Strengthening Global Credit Management Procedures

As more companies take advantage of international trade opportunities and expand into new markets, senior credit executives increasingly are being put in the position of needing to sign off on numbers for foreign receivables.

This trend encourages Credit executives to enforce uniform credit risk management discipline across operations worldwide by partnering with global trade credit insurers. Credit insurers help strengthen global credit management procedures by conducting thorough risk assessments on the creditworthiness of customers worldwide and providing an expert, third-party opinion in one standardized process. This helps senior executives feel much more confident about signing off on the validity of foreign receivables.

Global credit insurers also bring the power of large global databases on millions of companies whose performances they are underwriting. Policyholders can access these databases on line, in real-time, to assess prospects' creditworthiness, set credit limits and view policy coverage.

Sarbanes-Oxley Relief

Many U.S. companies use trade credit insurance as part of a comprehensive compliance risk management strategy. While credit insurance does solely assure Sarbanes-Oxley compliance in the credit area, it helps policyholders avoid large, unexpected write-offs, while providing a valuable third-party, expert credit opinion in the process. This is increasingly important as more and more of the corporate signing officers, who must certify the accuracy of all financial data in quarterly and annual reports, are requiring sub-certification from the individuals providing the underlying information.

When the National Association of Credit Management hosted a national teleconference about the impact of the Sarbanes-Oxley Act on the credit department, "What the Credit Executive Needs to Know About Sarbanes-Oxley," key points included:

• Unexpectedly high credit losses could be viewed as a misstatement of earnings upon Public Company Accounting Oversight Board (PCAOB) review.

• Even collecting more than anticipated could be questioned by the PCAOB, i.e., did the company knowingly deflate anticipated earnings.

• The best defense against such an interpretation is to have detailed documentation that the reasons for granting the credit were solid.

Credit insurance underwriters help support internal credit management procedures by conducting thorough risk assessments on the creditworthiness of customers and providing a documented second opinion on why and how credit decisions were made. A separate independent entity making a decision to insure a transaction provides an added “line of defense” against anyone thinking there was a misstatement of credit risk. defense” against anyone thinking there was a misstatement of credit risk.

Tailored Coverage Options

While most trade credit insurance policies have traditionally been issued on a whole-turnover basis, many trade credit insurers allow customers to tailor coverage more specifically to key account or even single-buyer transactions. Policies also can be designed to provide "first dollar" coverage using co-insurance, or a policy can be structured choosing from a variety of deductibles. These and other coverage choices are used to create an appropriate risk/cost ratio for a given insured.

Whole turnover policies cover a company’s entire eligible buyer base, with larger accounts approved by buyer underwriters and smaller accounts covered under a discretionary limit. Premium is payable as a percentage of insured turnover, which must be declared monthly, quarterly or annually by the policyholder. Whole turnover policies can be based on domestic or export trade, or a combination of both. Underwriting is done on the basis of previous loss record, future turnover and trade expectations, and the financial strength of the customer base.

Key account coverage gives policyholders an opportunity to move credit concentration risk off the balance sheet and cap company exposure. These policies are structured to cover a company's largest accounts following preapproval by a trade credit insurer's buyer underwriters. This type of policy can be tailored to fit any portfolio of risk, often resulting in more targeted coverage with lower premium payments.

Single buyer policies cover single or multiple shipments to one buyer and protect the seller from the date of the contract until the date of payment. A credit manager specifies the shipments to be covered and the length of time needed for the shipments to occur. The maximum policy period during which shipments can be made is generally one year, and can be written on a non-cancelable basis.

Some trade credit insurance policies are now available in a modular, or "building block" format. This allows coverage to be custom-fit to the specific needs of even small and medium sized companies more quickly and more cost effectively than with traditional policy structures.

Advantages of Private Market Trade Credit Insurance

It is important to compare policy options from private trade credit insurers against those available from the government (U.S. Ex-Im Bank. Private sector trade credit insurers often offer more extensive coverage options, superior underwriting capabilities, lower costs and simpler, faster processes. Private trade credit insurers are not limited to "off the shelf" products. They can design flexible, custom policies to cover clients' specific needs. And, unlike government insurer Ex-Im Bank, private insurers do not impose restrictions requiring goods to be made of more than 50 percent U.S. content. In addition, private trade credit insurers have thousands of underwriters located strategically around the globe and databases of credit information on tens of millions of companies worldwide. This allows for highly specialized country and trade-sector based underwriting expertise, which often enables private insurers to approve larger buyer limits in shorter timeframes. This timing advantage can often mean the difference between a profitable sale and a missed opportunity.

For larger accounts with $5 million or more in annual sales, private trade credit insurers commonly offer premiums that are 15 to 20 percent lower than Ex-Im Bank for international policies. Government trade credit insurance policies have time-consuming monthly administrative reporting requirements, while private trade credit insurers offer more simplified reporting with reports typically consolidated and handled on a quarterly or annual basis. While turnaround time from application to issuance of a policy or to have a credit limit approved is about 10 days or less for a private trade credit insurance policy, it can take 30 days or more for a government-issued policy.

Finally, many private trade credit insurers offer domestic and international debt collection services to assist with slow pay issues and further protect against the risk of nonpayment. Some of these insurers reimburse up to 90 percent of eligible collections expenses borne by clients. This is significantly less expensive than using a third-party collection service.

Pricing Structures

Trade credit insurance policy pricing varies, and is determined by industry, policy structure, credit-worthiness of the buyer, risk involved, country, past loss history, terms of payment and level of retention. Trade credit insurance companies can customize a policy based on individual company needs. A typical premium rate is about 0.07 to 0.75 percent of insured sales for international transactions and about 0.1 to 0.5 percent of insured domestic sales. Policies generally also include fees for the issuance of individual credit limits during the term of coverage. These rates ranging between \$25–\$75 per limit for domestic accounts, and \$50–\$140 for export limits on foreign companies.

Conclusion

In Europe, where cross-border trade has been a fact of business life for centuries, trade credit insurance is a standard part of corporate operating procedures. The U.S. continues to experience a rapid growth curve as credit executives embrace the trade credit insurance advantages. Those companies are discovering that today's trade credit insurance offers advances in underwriting, policy terms and pricing that generates clear competitive advantages not only when exporting, but for domestic and international trade as well. As a result, trade credit insurers are seeing positive and sustained growing demand in the U.S. for this proven, cost-effective way to capture opportunity and transfer risk.