

CREDIT INSURANCE

Certainty in an uncertain world

By Rick Bridges and Pete Shiptenko



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There are countless transit risks and exposures in project cargo. While we are all relieved when cargo arrives at its intended destination undamaged and on time, one of the largest exposures often remains. Whether you play the role of shipper, transportation intermediary, carrier, customs broker, or even an insurance broker, accounts receivable is perhaps the largest yet least protected exposure. Business bankruptcy filings in the U.S. alone increased from 19,000 in 2006 to 56,000 in 2010 — and this increase is consistent worldwide.

Accounts receivable insurance, also known as credit insurance, can be misunderstood because uninformed users sometimes misjudge its conditionality, treating it more as a guarantee. However,

understanding the conditions and expecting responsiveness from one's insurance partnership within those terms is a reasonable stance for our clients.

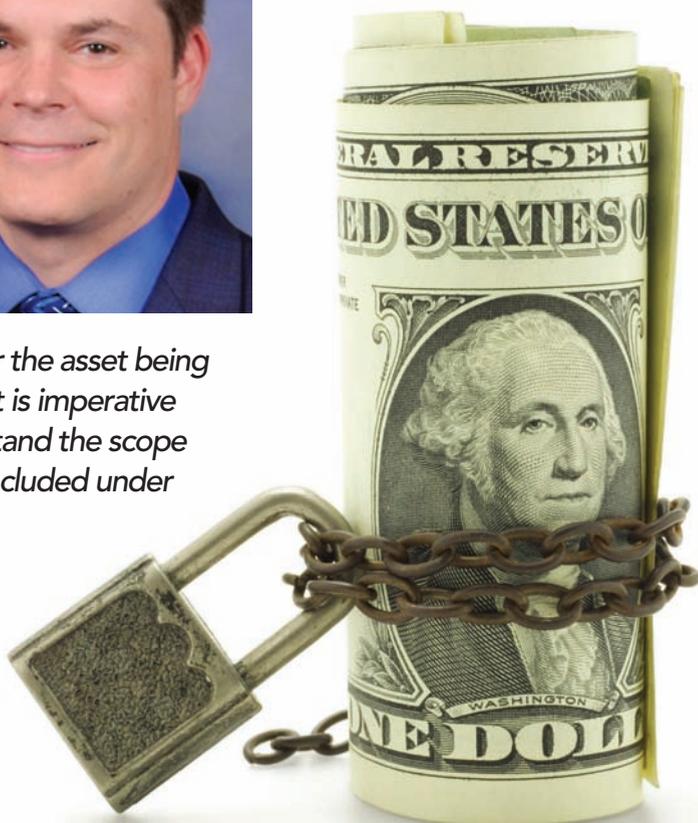
Those skeptics who have not undertaken such a partnership would be surprised at how effective credit insurance coverage can be in support of their products and services.

When used to bolster a company's ambitions in foreign markets, export credit insurance usually includes coverage for nonpayment of insured accounts receivable because of political risks. A buyer issue is one thing, but a foreign government problem is another, often more unpredictable and certainly larger in scope. A good example of this risk was when the Russian government declared a moratorium on all foreign debt in 1998, including trade debt, as a measure to keep hard currencies in the country during its financial crisis. Usually, there are specific definitions of what political risk is covered — and is not covered — under an export credit insurance policy.

One interesting aspect of this coverage is while a company cannot credit-insure as a commercial risk a related company's accounts receivable that it is owed from another country, it may insure that related-company's accounts receivable against a foreign government risk, in case the foreign government might cause the nonpayment of the inter-company accounts receivable under a covered political risk peril.

There is also a stand-alone political risk product available from the market. This coverage usually protects foreign assets such as plants, machinery, dividends, or even loans to a foreign entity whose repayment depends on the uninterrupted business success of a foreign entity.

No matter the asset being covered, it is imperative to understand the scope of perils included under a policy. For example, these can include confiscation of assets by a foreign government, loss due to the inability to transfer funds out of country, loss due to civil insurrection and riot or contract frustration where a foreign gov- →



ernment does not allow the completion of a project after a seller has incurred significant production expense.

In general, companies use credit insurance for one of three reasons: as a sales/marketing tool to help increase or

maintain a certain market share through the extension of credit to buyers, as a tool to facilitate financing by increasing the collateral pool with one's lender, and as a risk mitigation tool to help a company apply its business strategy while hedging

its threat of nonpayment by buyers.

Currently, multibuyer (whole-turnover, key-account, region-specific, and industry- or product-specific) and single-buyer credit insurance policies are available in both cancelable and non-cancelable formats, with more providers offering non-cancelable than at any other time in this industry. A non-cancelable policy means that an insured credit limit on a buyer cannot be rescinded by the insurer.

Consequently, non-cancelable coverage is more costly than cancelable coverage. In North America, the market has rebounded strongly from the troubles of 2007-2009. The number of insurers with available capacity for U.S. and Canadian companies has grown roughly 20 percent. This is a mix of new insurers and old names entering the market from other global regions.

As a result, there is more competition on every deal, and underwriters are looking to apply their available capacity in more creative ways. Insurers are offering multiyear policies at an increased pace to try and lock in clients for longer terms in exchange for lower pricing.

The availability of more single-debtor coverage is notable, and another good example of the market conforming to demand. The market currently appears artificially soft because of all these players trolling for business. It's not so good for the seller, and it's very good for the buyer.

So in the next review of your account receivables of a new project that calls for open account terms or a situation where you are forced to work in a financially perilous part of the world, consider credit and political risk insurance as part of your risk minimization strategy. Also consider that because these types of insurance are very specialized, so, too, should be the broker who can assist in providing the right options. ■■

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