
Atradius Presents:

Financing and Business Insurance Part 2:

Introduction to Credit Insurance

Brett Halsey
President



Atradius Presents – Introduction to Credit Insurance

■ **What is Credit Insurance?**

- Definition of Credit Insurance
- Difference of Credit Insurance from Financing



Credit Insurance vs Factoring

Credit Insurance:

Credit insurance protects your commercial accounts receivable from unexpected and catastrophic losses, resulting from insolvency, "non-payment" by your buyers, and political risk.

Factoring:

Factoring is a simple form of commercial finance in which a business sells their account receivables to a factorer at a discount so it does not have to wait the normal terms for 1st invoices to be paid.

The major difference is that factoring provides financing and credit insurance provides risk mitigation.



Common Types of Credit Insurance Policies



CANCELLABLE

- Whole Sales Policy
- Key Account Policy
- Single-Buyer Policy
- SPU (Special Products Unit)

NON-CANCELLABLE



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Types of Policies

- Domestic
- International
- Global



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Type of Coverage Provided

- Insolvency
- Protracted Default
- Political Risk



Political Risk Examples

- Government Moratorium
- Contract Frustration
- Transfer of Payment
- Discharge of Debt
- War, Revolution, or Riot
- Natural Disasters
- Public Buyer Default

Political Risk Examples.doc



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■ **Credit Insurance Terms/Definitions**

Credit Insurance: Credit insurance protects your commercial account receivables from unexpected and catastrophic losses, resulting from insolvency or "non-payment" by your buyers.

Factoring: A simple form of commercial finance in which a business sells its accounts receivables (invoices) to a factorer at a discount, so it does not have to wait the normal 30-90 days for its invoices to be paid.

Recourse vs. Non-recourse: With recourse the company selling the receivables retains the risk of nonpayment and will have to reimburse the factorer for any unpaid receivables or usually a discount will be taken up front to account for losses. If there is no recourse then the factorer assumes the risk of nonpayment.

Protracted Default: Coverage for nonpayment. Typically the buyer must be 6 months past due, the amount outstanding can not be in dispute, and the Insured must have taken all reasonable steps to collect the debt including referring the account to a collection agency.

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■ **Credit Insurance Terms/Definitions - continued**

Insolvency: Typically refers to when a company files bankruptcy.

Below are some more specific definitions:

"Insolvency" shall occur if:

- a. An involuntary bankruptcy is made against the buyer, or the buyer files for Chapter 11; or
- b. In the course of execution of a judgment the levy of execution fails to satisfy the debt in full; or
- c. A valid assignment, compromise or other arrangement is made for the benefit of the buyer's creditors generally; or
- d. An effective arrangement is made for the liquidation of a buyer; or
- e. An administrative or other receiver or manager of any of the buyer's property is appointed; or
- f. You show, to our satisfaction, that the buyer's financial state is such that even partial payment is unlikely and that to enforce judgment or to apply for a bankruptcy or winding-up order would have no foreseeable result other than one disproportionate to the likely cost of the proceedings; or

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■ **Credit Insurance Terms/Definitions - continued**

g. An event has occurred elsewhere than in the United States of America, which, to pay an outstanding receivable past the original due date as indicated in the policy. This can be used by the insured to maintain a relationship with a buyer who they feel is only having a short term financial problem.

Continuous Policy: A policy that automatically renews at the end of the term unless otherwise stated by the Insurance Carrier or the Insured. This clause allows for seamless coverage during the renewal of a policy. Without continuous coverage shipments made at the end of the policy may not be covered under the renewal policy.

Back Sales Coverage: Covers sales made prior to the start of the policy. All sales eligible must not be past the MEP at the start of the policy. Typically endorsed on a 60-day basis or to cover the Insured's normal terms of sale.

Construed Cover: Provides Coverage to an Insured for deliveries they are irrevocably bound to deliver, to buyers who have had their limits cancelled. Typically premium is charged on increments of 30 days of cover. When coverage starts varies between carriers. Usually written from either the date the order was taken or at the time the limit was cancelled.



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■ **Credit Insurance Terms/Definitions - continued**

Claims Made Policy: A Claims Made Policy is risk attaching which means that the risk attaches at the time of delivery. So if the policy is cancelled or non-renewed you are still covered on all shipments made during the term of the policy.

Loss Occurring Policy: A Loss Occurring Policy will only pay a claim if the policy was in effect at the time of the delivery and is still in force at the time of the loss.

Work in Progress (WIP-Also called Predelivery Risk): Covers an insured against the insolvency of a buyer while they are manufacturing specialized goods. This endorsement is used to insure goods special ordered which cannot readily be resold for a reasonable price. The insured is reimbursed the fair market value (cost of labor, goods and or processing) of the work in process less any recovery and coinsurance.

Threshold or Non-Qualified Loss (NQL): A threshold is a minimum amount needed for a loss to qualify as a claim. For example a policy with a \$5,000 threshold would pay a claim on a loss of \$5,500 but a claim of \$4,900 would not qualify as an eligible loss under the policy.



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■ **Credit Insurance Terms/Definitions - continued**

Minimum Retention: The minimum amount of loss an insured must retain on each claim. Using the example for threshold above: on the claim of \$5,000 the policy would pay \$500 on the claim of \$4,900 nothing would be paid. Another example would be a \$5,000 Minimum Retention on a policy with 20% coinsurance that has a claim of \$15,000. Without the minimum retention the amount paid on the claim would be \$12,000 (\$15,000 x 80%) but in this case the minimum retention is \$5,000 therefore the amount paid on the claim is only \$10,000.

Whole Turnover Policy: A policy that covers all open term sales.

Key Account Cover: A pre-designated credit limit from which all limits above will be submitted for coverage. Premiums will be calculated against only sales to customers above the key account level. This policy is an alternative to the All Sales policy to provide coverage on predefined buyers, who upon default, would cause a significant financial impact.

Datum Line: Similar to a key account structure, it requires the insured to have an outstanding balance with the buyer equal to or greater than the endorsed Datum Line with in the preceding 12 months in order to qualify for claim.



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■ **Credit Insurance Terms/Definitions - continued**

Discretionary Limit: A credit limit the insured is authorized to grant to buyers who meet specified requirements. The discretionary limit is typically used on an All Sales Policy to provide blanket cover to a large number of buyers.

Forfeiting: A method of trade finance whereby the forfeiting bank purchases, on a without recourse basis, unconditional debt obligations arising from the supply of goods and/or services.

In Forfeiting transactions, the exporter agrees to surrender the rights to claim for payment of goods or services delivered to an importer under a contract of sale, in return for a cash payment from a forfeiting bank. In exchange for the payment, the forfeiting bank takes over the exporter's debt instruments and assumes the full risk of payment by the importer. The exporter is thereby freed from any financial risk in the transaction and is liable only for the quality and reliability of the goods and / or services provided.



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■ **Credit Insurance Common Endorsements**

- Work in Progress (WIP)
- Discretionary Limit Endorsement
- Joint Insured Endorsement
- Key Account Endorsement
- All Sales Endorsement
- Back Sales Coverage Endorsement
- Threshold Endorsement
- Sales Exclusion Endorsement
- Special Order Goods Endorsement
- Binding Contract Coverage
- Trade Finance Endorsement
- Bank Loss Payment Endorsement
- Debtor In Possession Cover
- Protracted Default Coverage Endorsement
- Third Country Risk Endorsement



Choosing Credit / Payment Terms

The spectrum of credit/payment terms

- Extended terms, installment notes
- Open account, clean drafts
- Time draft (D/A)
- Consignment/retention of title
- Sight draft (D/P, C.A.D.)
- Cash against goods, C.O.D.
- Advised letter of credit: sight & time
- Confirmed letter of credit
- Cash in advance



Risks Faced by Exporters

Slow payment/default	Financing risk	Commercial risk
Bankruptcy		
Contract repudiation	Contract risk	Country risk
Contract dispute		
Abusive bond drawing		
Foreign exchange control legislation	Political risk	Country risk
Discharge of debt legislation		
Government repudiation of debt		
Payment moratorium		
Insurrection/overthrow/domestic turmoil		
Non-payment due to war	Transfer/economic risk	Country risk
Non-payment due to natural disasters		
Currency inconvertibility	FX risk	Country risk
Currency fluctuation/devaluation		



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■ Benefits of Credit Insurance

- Risk Mitigation
- Increased Sales
- Credit Management
- Facilitate Financing
- Special Needs of large Multinationals



Protect Your Balance Sheet!

- If you are like most companies, 80% of your business comes from 20% of your customers. Imagine the impact on your company if one of your best customers were to stop paying you.
- Manage your bad debt reserve and write-offs with greater certainty.
- Take excess bad debt reserves back into income.
- Improve your cash-flow; no big surprises!

Credit insurance can give a company peace of mind to expand their market!



Enhance Your Credit Management!

- Receive unbiased, third-party credit opinions on your customers.
- Reduce your credit investigation costs and ensure sound Credit Management procedures.
- Accurately budget and forecast your premium costs and bad debt write-offs.

...some premiums may be tax deductible!



Improve Your Financing!

- If you have a few large customers or do a lot of exporting, you are viewed by banks as a bad credit risk! Having credit insurance improves your own creditworthiness.
 - Reduce **concentration risk**
 - Increase the pool of "eligible" receivables, often including foreign receivables
 - Increase **advance rates**
 - Reduce **interest rates**
 - Strengthen **client relationships** - you can offer better financing terms backed by the knowledge you can obtain funding
- Some banks will purchase insured receivables, enabling programs where you can offer customers financing that will actually be carried by your bank.
- If you are securitizing your receivables, credit insurance can be used to overcome concentration limits and to make foreign receivables "eligible."



Increase Your Sales!

- Credit insurance enables you to sell more goods/services on longer credit terms while substantially reducing the overall risk of exposure to non-payment from your buyers.
- Credit insurance allows you to offer open account terms; a more competitive alternative to requiring customers to obtain letters of credit.
- Credit insurance assists you with entry into new markets.
- Distinction between new and existing customers.

An increase in sales will help you to finance your increasing receivables



Key Policy Point

When using credit insurance, it is important to remember this key point:

Insurance does not cover disputed invoices



Questions or Comments?



Brett Halsey
President
Atradius Trade Credit Insurance, Inc.

230 Schilling Circle, Suite 240
Hunt Valley, MD 21031-8643

brett.halsey@atradius.com
www.atradius.us


