Michael Miller

Credit Insurance: Protection against Nonpayment Risks

You lock your home when you leave for the grocery store; you hear the beep of your car after you park and exit. There is home, car and health insurance and, as we have seen recently, flood and hurricane policies. These are all here for security, protection and those just-in-case moments. If you are willing to do everything in your power to guard against unfortunate events in your personal life, why would you not do that in the professional world? There are risks everywhere we turn, but there are ways to mitigate the effects they have.

In business credit, there is trade credit insurance. This coverage is "straightforward risk mitigation for not getting paid," said Meridian Finance Group President Gary Mendell. Some of the risks that may cause your invoices not to be paid include debtor bankruptcy, cash-flow issues, bad faith and other problems.

> Policyholders who comply with all of their terms and conditions should feel confident that they will be indemnified "since there is no mystery to compliance," Mendell said.

These risks are compounded by growing demand for credit in the U.S. and around the world, according to Mendell. Facing limited access to capital, some customers are unwilling or unable to pay cash in advance or open letters of credit. Other customers are insisting on longer payment terms, regardless of the terms stated on suppliers' invoices. The risks associated with meeting this growing demand for credit lead creditors to protect their assets with trade credit insurance. According to Mendell, credit insurance allows companies to:

- Protect their accounts receivable against virtually all default risks.
- Extend competitive open-account payment terms with confidence.
- Expand their U.S. and international sales and market share.
- Increase the profitability of doing business here and abroad.
- Arrange attractive financing for domestic and foreign receivables.

"When selecting an insurance company the most important factor is the coverage that you will get," said Equinox Global Limited Chief Markets Officer Frank Masteling. For example: what percentage of your buyer portfolio is accepted by the insurance company, what amount of freedom do you get to set credit limits yourself and for what period are your credit limits valid. "Of course, the premium rate is also important but, in our opinion, only after you have looked at the other items," explained Masteling.

There is also a financing benefit provided by credit insurance. "Banks and other lenders will lend with higher advance rates on A/R that are insured rather than uninsured. Assigning your bank/lender as your policy's loss payee makes your receivables more attractive as collateral," said Mendell.

"Our experience is that most credit insurance policies are bought for financing reasons," added Masteling. "With credit insurance, it is easier to finance your receivables portfolio with a higher advance rate. It could also have a positive impact on your interest rate."

Banks are taking a closer look at assets. For international sales, domestic banks and nonbanks will not finance foreign A/R unless it is insured. This is due to the additional risks to think about when receivables travel internationally. "This can be anything from a civil war happening in the country of your buyer to restrictions to the payment of foreign currencies from the country of the buyer. These risks can all be covered in your credit insurance policy," Masteling said.

As with other forms of insurance, just because you have credit insurance doesn't mean you will need to use it. Companies can and should take normal precautions and make businesslike efforts to collect payments. If your customer files bankruptcy you may want to, or your insurance policy may require you to, file your claim right away. If your customer is paying slowly, you may not want to compromise your relationship with the customer by filing a claim before making every effort to collect on your own. "Insurance companies may even be willing to coordinate with you on your recovery efforts precedent to your filing a claim," said Mendell.

More companies are starting to use trade credit insurance, yet it is still not utilized as broadly in the United

States as it is elsewhere in the world. Within credit insurance there are different types of policies such as whole turnover, key account and single-buyer coverage. New kinds of policies are even more flexible about the spreads of risk that need to be insured.

Premiums on credit insurance are "typically a fraction of 1% on sales," according to Mendell. Rates are being driven lower due to expanding market capacity. Longstanding insurers including Atradius, Coface and Euler Hermes have been joined in the market by AIG, Chubb, FCIA, HCC and QBE, as well as newcomers like Equinox Global, Markel, XL Catlin, Beazley and Allied World Assurance Company.

Complying with the terms and conditions of a trade credit insurance policy is not difficult, but there are more moving parts than with other forms of insurance, said Mendell. The policy will work as it is written to do so, which is why reading and understanding all the terms and conditions is so important. A specialized credit insurance broker will not only shop your coverage requirements among all the underwriters (you will often have two, three or more insurers to choose from), they will also walk you through your policy to ensure you understand how to comply—and of course they will be by your side in the event of any claims.

Policyholders who comply with all of their terms and conditions should feel confident that they will be indemnified "since there is no mystery to compliance," Mendell said. In order to get paid on a claim, you need to pay the premium, have insured credit limits in effect on your customers, file during the claim window and have conforming documentation such as purchase orders, invoices and bills of lading, he added.

"Our experience at Equinox Global is that 98% of the claims that are filed will get paid," Masteling said. Some of the best practices as the insured party involve doing and not doing what the policy says. "Many policy requirements are consistent with normal diligent credit practices anyway—doing things you are or should already be doing for commercial reasons," said Mendell.

"Credit insurance is only used by a limited number of companies at this moment," according to Masteling. "Through further development of the product, the penetration of credit insurance can be improved. Next to that, we are making the product more relevant for companies outside the traditional production and trading companies. This means we see a great future for credit insurance with further growth of the number of companies using it," he predicted. ■

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