

Trade Credit Insurance Protects Receivables and Enhances Credit Access

By The Wells Publishing Staff

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By James Dezell

With the global economy still in recession, a growing number of U.S. manufacturers and distributors are looking for effective ways to protect their revenue streams. Many firms are looking to trade credit insurance to guard against the possibility of a default by their business partners; particularly those marketing their goods and services to vulnerable industries or for export.

Demand for trade credit coverage has skyrocketed in the past 18 months; but insurers are being more cautious about the credit risks they are willing to accept, and are declining a significant percentage of applications. And existing policyholders are seeing as much as 20 to 30 percent increases in their renewals while also being forced to accept larger deductibles and higher coinsurance.

Looking to effectively manage their trade credit risk portfolios, many trade credit insurers are shying away from industries most affected by the downturn; choosing rather to focus attention on smaller, less complex exposures, as well as on programs that are not concentrated around troubled industries. This shift towards more manageable risks and programs represents a significant opportunity for mid-sized businesses wanting to purchase this coverage for the first time or expand their existing credit insurance program.

In the current credit environment, trade credit insurance can provide significant benefits to a business in terms of both protecting critical revenue streams and possibly enhancing a firm's overall credit picture. With corporate bankruptcies on the rise around the world, financial institutions may view **insured** receivables more favorably when evaluating a company's overall credit profile and making credit decisions.

Trade credit insurance provides financial protection for a company's accounts receivable against losses generated by: a customer's insolvency; protracted default; or political events that prevent payment. The coverage can be written to protect domestic receivables, foreign receivables or both. Note, however, that mere disputes between debtor and creditor are generally not covered by credit insurance - unless the dispute ends in the debtor's bankruptcy and resolved in the creditor's favor.

Accounts receivable can represent more than 35 percent of a company's current assets; many companies view protecting this asset class as prudent given that most of their other assets (such as property, equipment and inventory) are insured.

As a line of coverage, trade credit insurance has been around for more than a century; it emerged as an outgrowth of "factoring" - the purchasing of accounts receivable, typically by banks and lending institutions. Many of the world's largest credit insurers are based in Western Europe and have ties back to the various governments.

European governments established and supported credit insurance enterprises following the First and Second World Wars to stimulate exports. Several industrialized countries, including the U.S., still have government-sponsored credit insurance operations to encourage foreign trade. Credit insurance has gained popularity throughout the U.S. during the past few decades —due primarily to the high profile bankruptcies that have peppered the American financial and industrial landscape in the past several years.

Policyholders can gain additional benefits from their relationships with trade credit insurers such as access to credit information on potential business partners and access to capital. A number of the carriers maintain credit information on some 50 million companies around the world and many credit insurers can assist a company's credit department in identifying accounts receivable risks domestically and globally. And, as noted, the programs also may be useful in lending arrangements.

Trade credit is a versatile insurance coverage. It can be structured to apply to one major business partner, several key accounts or to insure an entire book of business in specific geographic markets. The coverage also can be concentrated on a trading partner involved in a bankruptcy proceeding or a number of accounts that are considered highly distressed.

Debtors, in some instances, purchase credit insurance on behalf of their creditors. While these transactions, generally referred to as "reverse flow," are initiated by the debtor, the creditors are, in effect, the policyholder and have an obligation to adhere to the contract's terms and conditions.

Businesses seeking to purchase credit insurance must clearly present to insurers their means and methods for auditing and reviewing their current exposures. Additionally, they must show how they manage these risks. Being able to demonstrate sound credit management procedures is also important for discussions with insurers.

As a condition of coverage, credit insurers usually require policyholders to report sales either on a quarterly or annual basis. Plus, they also want to be informed of delinquent accounts that are 60 or 90 days past due.

Ten insurers currently are licensed to write these programs in the United States, ranging from mono-line trade credit-only insurers to larger, multi-line insurers and export credit agencies.

James Dezell is Senior Vice President of Trade Credit Practice with Marsh Inc. © 2009 by Wells Publishing, Inc.