CREDIT INSURANCE TRENDS

Trade Credit Insurance – More than Insurance

BY CASEY JOHNSON

Casey Johnson of Hylant provides the ins and outs of trade credit insurance.

The global trade credit market continues to grow with increased international business opportunities and carriers making trade credit more accessible to the market. You may be asking – what is trade credit insurance? Trade credit insurance (TCI) insures your accounts receivables against losses due to bankruptcy, unforeseen insolvency, or protracted default. But, trade credit insurance is more than just insurance. Once your A/R is insured, it is a secured asset, and can be used to leverage many ROIs.

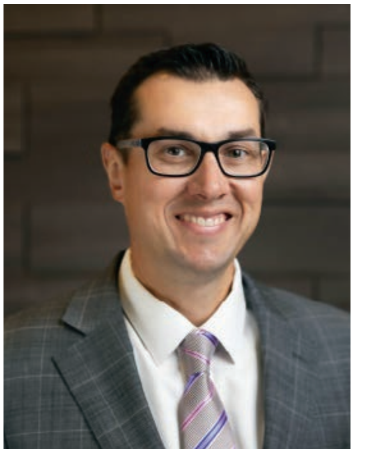
Why do companies acquire a trade credit insurance policy? Trade credit can help build a healthy pipeline of new revenue, increase access to capital, prevent a catastrophic loss, and strengthen an organization's balance sheet. Here are the top four motivating factors for trade credit Insurance.

Lending/Finance Support: TCI is a tool that is used to support the financing activities of an insured. It is common to see exclusions in a borrowing base for foreign A/R, extended terms, high concentrations, and other common exclusions. TCI is a vehicle to include more of the total accounts receivables into the borrowing base. The lender is the first payee and would be endorsed on the policy through the lender beneficiary endorsement.

Balance Sheet Support: Most companies that do not formally purchase TCI self-insure the risk by utilizing a bad debt reserve. A bad debt reserve allocation is based commonly on past lost experience and forecasted lost expectancy. Trade credit can offer a predictable outcome and set a bad debt figure without the question of reserves or allocations being enough. Example: $1 of a bad debt reserve protects $1 of loss. $1 of a trade credit premium could protect upwards of $100+ of bad debt.

Increasing Top Line Sales: Trade credit is a tool to expand top-line growth safely and aggressively. Trade credit can help make a credit decision in as little as 90 seconds, making speed to market a reality. The TCI carriers have the largest library of privately held data in the world. The information is comprised of financial and real-time trade feedback. Use this security to offer higher credit limits or longer terms without taking any additional risk. Terms are key to a negotiation and could be seen as a competitive advantage to be more flexible.

Managing losses: It is common to have a certain level of losses in a fiscal year. Trade credit pays a claim when a commercial invoice turns into bad debt. The severity can range from smaller, normal losses to the potential for a catastrophic loss of a key customer. The policy can capture those losses and mitigate the time and resources normally associated with bad debt. TCI insures that one large key relationship does pose a catastrophic loss potential. This is often referred to as the "sleep insurance" portion of the policy.



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As trade credit continues to grow globally, the carriers have responded well to the demand for innovation. Carriers have looked at the supply chain in more depth and looked at ways they can enhance the current offering. Here are some ways the policy has evolved to offer some extended coverages.

- Multi-Year Policy – Carriers are seeing long term relationships and are offering multi-year policies with a premium enhancement. Most commonly these are two-year policies periods.
- Supplier Protection – With the growth of overseas supply chain, some carriers are offering ways insure the payment for production overseas. Traditionally, trade credit Insurance protected just the exiting of the products. Example: You send a down payment (Cash) overseas for a product to be made and the supplier becomes insolvent. This is a new offering that has come to market with more reliance on overseas manufacturing.
- Pre-Shipment Coverage – This endorsement adds coverage for Work in Progress. If a company produces a customized end-product, pre-shipment covers the work not yet invoiced at the time of insolvency. Pre-shipment coverage is often favorable in lender financing when we look at inventory or WIP.
- Hybrid Policies - A combination of traditional cancelable coverage with non-cancelable coverage on top key buyers on the same policy. The hybrid trade credit offering has brought non-cancelable coverage to the small to middle market. This offering has made it easier for lenders to incorporate policies into the lending equation.
- Technology – Carriers are investing in the platforms that connect the insured to the carrier. The technology has also incorporated aspects of connectivity directly between the insureds and the carrier partner. This means 24/7 365 days a year, you can log in and request credit, place a claim, or request more information. Accessibility could be made from anywhere. Accessibility is given to both the insured and the

named beneficiary, both are treated equally.

- Collection Support – Many of the carriers have invested heavily over the past years in their collection teams. This has offered a service that many companies already had today at a reduced cost. It married the guarantee of credit insurance with the in-house power of a full collections team. Some saw this an opportunity to utilize a collections strategy on the portion of their A/R that is self-insured. Companies see this as an alternative to mitigate the risk of non-payment.
- Industry Specialty – Carriers are positioning key individuals with expertise in markets, industries, and understanding of specific trade risks to bring value to the insureds. These resources bring real time information to the insureds on a real time basis. This means accurate and real-time information to help make key decisions within an organization.

As you get to the point of getting a trade credit policy, there are often two questions that get asked. (1) How do you determine the premium and (2) How does the premium get impacted? As a general guideline, the premium rate is .10-.25% multiplied by the sales revenue. The premium is normally impacted by the amount of risk shared with the insured and the carrier. Below are some of the most common "levers" which can impact the policy premium and rate.

- Sales Revenue – The revenue and size of a company are the main drivers of how the premium is derived. There are strategies to carve out buyers or segments of a company that are preferred to be self-insured. In lowering the sales revenue, we are factoring the policy will drive the overall premium down.
- Deductible – As is common with insurance, the deductible can have an impact on premium. By increasing the risk share of the policy, you can impact the policy rate.
- Coinsurance – The standard in the industry is 90% of the invoice is insured with a policy. Carriers will look at reducing the percentage insured in favor of a lower premium rate.
- Policy Limit/Max Claim – If a lower policy limit or maximum claim amount fits with the risk strategy, the lower policy limit can impact the premium rate.
- Minimum Claim Amount: The minimum claim refers to the lowest amount that qualifies for a claim. A strategy to increase the minimum claim threshold can provide a lower premium rate.

The credit insurance market is not as mature as some of the other property & casualty lines of coverage, despite being around over 100 years. The pool of carriers most common in the U.S is less than 20. The top three carriers are Allianz Trade Credit (formally Euler Hermes), Atradius Trade Credit, and Coface North America.

"When" to buy credit insurance could make a big impact on the coverage available and pricing. With risk, the best time to buy it is when you are least likely to need to use it. During the peak of a pandemic or during global conflict is not the time to get the best terms or coverage. The price is inflated, and the coverage is only a fraction of what you would see in a more normalized market. The companies that had the best coverage and strongest terms during the last major events acquired policies years or decades in advance. Those who had relationships with the markets maintained a much more favorable trade environment. That was a competitive edge, and a tool organizations could lean on when looking how to outpace a competitor.

What we know is the future is unknown and that history often repeats itself. There will be a global event or supply chain disruption causing uncertainty constantly. Some of this can be looked to be funded by the allocations already made for bad debt. Tap into all the ways it can help grow sales, access capital, and insure cash flow. Let trade credit insurance be more than insurance.

Casey Johnson is a client executive with Hylant. His primary focus is working with commercial clients on property and casualty risk management. Johnson has a vast knowledge specializing in the trade credit market. This includes an expertise in trade credit insurance, EXIM insurance programs, political risk, and mitigating financial risk through the PUT market. He earned a BS in marketing from Ferris State University located in Big Rapids, Michigan. He can be reached at casey.johnson@hylant.com.