

An Introduction to Credit Insurance

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Pretend for a moment that you are a Foreign Importer trying to expand business. You realize that denim jeans have become very popular in your country, and you locate two suppliers who offer the product you want – one in the United States and one in Spain. The American company requires a Letter of Credit, whereas the Spanish firm offers Open-Account terms. Assume everything else as equal, which supplier do you think the Importer will choose?

Most buyers, of course, prefer to deal on Open-Account terms. Unfortunately, most U.S. Exporters traditionally require ***Letters of Credit*** from their foreign customers – putting their company at a ***competitive disadvantage*** as well as taking a chance on restricting the opportunity or losing the business.

As the marketplace for goods and services expands beyond our borders, U.S. companies need assistance in remaining competitive, and the above story is not an uncommon scenario. Payment terms in many cases can make or break sales. Many foreign buyers are use to conducting business on Open-Credit Terms and not on Letters of Credit. Your Clients probably have “Lost-Sales Stories” with the following scenario: We had the best product and the best price, but we lost the deal because of our restrictive payment terms.

You can help your clients and prospective clients overcome future disappointments!

Credit Insurance is an insurance policy that protects a company’s Accounts Receivable, and it provides a guarantee of payment. This can benefit an organization in a number of ways including:

1. With the security of a Credit Insurance policy, a company can extend or increase terms to their domestic or foreign customers. With the Cash-Flow benefits of Open-Account or Extended Terms, the organization will gain a competitive advantage as well as their customers will gain the ability to buy more product.
2. The product can allow a company to maximize their Bank Facility. By presenting their bank with secured A/R, the company should benefit with higher advance rates, lower interest rates and the inclusion of previously excluded A/R in the bank formula.
3. Credit Insurance can crystallize an organization’s Bad Debt exposure. This provides certainty to earnings, and it can also allow an organization to reduce the Bad Debt Allowance on their Balance Sheet.
4. Credit Insurance provides the policyholder with a Credit Information resource. Medium to small companies typically rely on an individual wearing many hats to assume the Credit Management role. Credit Insurance can provide that individual with a “second-set of eyes” on their existing customers, and it will give a company a “free” credit opinion on new opportunities and companies.

In Europe, credit is granted in a much different light. It is common to provide buyers with open account; however, it is also common for European exporters to buyer credit insurance just as they purchase traditional Property and Casualty coverage. In fact it is estimated that over 65 percent of all exports out of Europe are insured by credit insurance, compared with less than 5 percent in the U.S. Exporters in the U.S. are not as aware when it comes to understanding and using Export Credit Insurance.

It seems as if the trend of the U.S. exporter may be changing. However, as long as U.S. companies make it difficult for overseas buyers by insisting on Letter of Credit, Cash in Advance or other forms of secured payment, they will be less and less competitive. U.S. exporters must begin to realize just as they source goods and services internationally so do their prospective and current customers. American exporters have to accept some of the financial risk.

It sounds like a good idea, but what is the cost to my client? Premium is derived by a number of factors. One of the primary determinants is the buyer's financial stability and the country in which the buyer resides. Other considerations include terms of sale and the types of transactions involved. Generally, the insurance cost is roughly 1 half of 1 percent or below for export transactions and 1 quarter of 1 percent or below for domestic or U.S. transactions. However, this can vary depending on the risk. The risks involved in transactions to buyers in Europe versus Nigeria can vary greatly.

While this product is a new and/or "out-of-the-box" insurance coverage for a majority of companies, most organizations would benefit from a program. This also provides the Insurance Agent with a product to protect the one uninsured asset in a company's portfolio; Accounts Receivable.

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