Protecting Against Non-Payment

Summary

In this session we will discuss Export Credit Insurance. Our goal is to explain how exporters can protect themselves against non-payment from their foreign buyer. We will review different payment mechanisms and introduce export credit insurance as a solution to lower your transaction costs while protecting your bottom line.

Introduction

Welcome to the LA Export Series podcasts brought to you by the El Camino College Center for International Trade Development. Each podcast will focus on a specific export topic presented by an industry expert. Our complete series will walk you through the trade process from getting started to getting paid and delivering the goods.

In this session we will discuss Export Credit Insurance. Our goal is to explain how exporters can protect themselves against non-payment from their foreign buyer. We will review different payment mechanisms and introduce export credit insurance as a solution to lower your transaction costs while protecting your bottom line.

Presenter: Brett Tarnet

Our Presenter is Brett Tarnet, Insurance Broker of Brett Tarnet Insurance Services. Brett Tarnet is a licensed insurance broker, specializing in export and domestic credit insurance. She earned an MBA from UCLA's Anderson School, and prior to becoming a specialty broker of export credit insurance, had a successful career in marketing. Brett's business and finance experience are integral to the philosophy of Brett Tarnet Insurance Services. Credit Insurance is a financial tool, enabling business growth.

Balancing Risks And Benefits

There are a number of options available when you're establishing the terms of sale in an export transaction.

Cash in advance offers the most benefit to the seller, and highest risk to the buyer. Open account transactions offer the buyer advantages of low cost and low risk. In the middle of the risk continuum, you can choose several documentary collections models: draft payments, and letters of credit.

Note that credit card payments carry the risk that the transaction is fraudulent, this is a growing concern as banks electronic information has been hacked.

Open Account

The choice of offering open account does offer competitive advantage to the seller in the marketplace, as you will be offering least-cost financing to your customer. You may find that this is a requirement in markets where your competition is offering these kinds of favorable terms.

Know Your Customer

The first step to mitigating your risk in any transaction is to KYC: Know Your Customer. Personal visits to the buyer's office, trade references, bank references, credit reports, and financial statements are some tools you can employ to reach an informed decision about your customer's credit worthiness, and ability to engage in a transaction with your company. Even if you're not planning to extend credit, you should know something about the company you plan to do business with, and identify potential problems.

Customer Credit Application

You can begin your efforts to know your customer with a customer credit application. The example on this slide is more extensive than the one you most likely use for a U.S. customer. Ask for the legal name and DBA, as well as a Tax ID number, and of course the physical address. All of these data points will make it easier to continue your quest for additional information about your customer, especially when purchasing a credit report. Note that the vendor reference section asks for contact name, and an email address. Your international customer may give an international trade reference. Be sure to find out the currency denomination if you get a foreign reference.

Credit Insurance

An additional risk mitigate you can employ when you're offering open account terms is to purchase a credit insurance policy. Such a policy can protect your company against the risk that your customer may not pay. There are a variety of risks of non-payment beyond the obvious that your customer goes out of business, or has a cash flow problem. In an international transaction you also face political risks like currency risks, international or internal conflicts, even trade embargo.
You may find that the favorable terms your competitors offer are backed by such a facility.

What Is Credit Insurance?

Credit insurance is a true insurance product. It protects your asset, the accounts receivable, allowing you to file a claim in the event that the account does not convert to cash.
You will find in most cases that credit insurance is affordable, costing in most cases less than 1% of the invoice value, average about .5%.

Such insurance is available for both export and non-export transactions, but the additional risk associated with export transactions, and complexities surrounding collection in foreign markets are drivers for using this product in the export market.

Who Offers Credit Insurance

The Export Import Bank of the United States offers credit insurance for exporters of U.S. made goods and U.S. originated services.

There is also a private market for credit insurance, dominated by a small number of large firms, several with their roots in Europe, where this product has its origins.

Choosing A Credit Insurance Solution

Most purchase decisions start with price, but cost will not be the only driver in your decision to purchase a particular policy. Availability of cover for a key buyer: one who presents a higher risk, or a large amount may be important to you.

Acquiring Credit Insurance

Credit Insurance underwriters need to evaluate the portfolio of risk they as being asked to cover.

You will be asked to provide your accounts receivable aging, sales volumes by country, terms of sale, a list of key customers, sales and credit limits, and bad debt losses in recent years.
In some cases the underwriter may ask for your company financials, and perhaps your company's credit and collection procedures.

The quotation in response to your submission will include pricing, buyer approvals, percentage of cover, and deductible. Most of these types of policies cover about 90% of your invoice values.

Year In The Life Of A Credit Insurance Policy

Unlike most insurance policies, credit insurance is often subject to change during a policy year. As a business grows, and acquires new customers, coverage needs to be increased to match. A series of interactions takes place with your underwriter each time a change is requested and approved.

Year In The Life Continued…

This interaction is best enabled by employing a broker who specializes in trade credit insurance. Their knowledge of credit, and the underwriting process can ensure that the policy is correctly configured, with the least cost and administrative burden to you. Just like all broker relationships, the underwriting company pays your broker, so their service is a benefit at no cost to you.

Claims In Credit Insurance

Credit insurance policies in general require presentation of documentary evidence of an insured transaction to succeed in getting a claim payment. Your broker should make you aware of the specific requirements associated with your policy.

A basic set of required documents for most claims would include a written purchase order, an invoice, and a shipping document. Also each customer must have a credit limit, and of course the premium must be paid when due.

Risk Mitigation Wrap-Up

In a nutshell, companies do face increased financial risk in export transactions.

There are a variety of methods for mitigating those risks. You should consider options and agree internally on a structure for credit and collections management for export transactions, then negotiate a best-fit solution with your customers.

Credits

Thank you for listening and special thanks to Brett Tarnet, Insurance Broker of Brett Tarnet Insurance Services for sharing her valuable time and international business insights. Check out our full line of LA Export Series podcasts on our website www.ExportAssist.org where you will find information on additional export topics with complementary tools and resources.
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