NASBITE Annual Conference

EXPORT CREDIT INSURANCE

A TRADE FINANCE TOOL FOR EXPORTING DURING THE ECONOMIC DOWNTURN

PRESENTED
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Exporting in the Economic Downturn

- Amidst the challenges in the world's present economic situation, there are also opportunities for growth.
- Many companies will continue to grow and in many cases their growth will come from export sales.
- While total export volumes may fall short of earlier projections, worldwide market demand for goods and services will continue to engender a considerable amount of international trade, and even expansion in some sectors.

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Purchasing Power in Other Countries

- The U.S. economy is projected to continue declining for some time before it begins to recover, but with just five percent of the world's population and less than one-quarter of global GDP, the U.S. is not the only country with purchasing power.
- While all countries are linked to some degree by economic interdependence, different cultural, political, and market forces will lead Europe, Asia, Latin America, and other regions each on their own trajectory.

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Customer Demand for Credit

- Facing limited access to capital in their own countries, as well as high interest rates and exchange controls, foreign companies are turning to their international suppliers for working capital in the form of longer payment terms.
- Exporters who seek to capitalize on the opportunities that will emerge in 2009 and beyond need to consider extending competitive credit terms to their international customers.

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Credit Terms as Export Sales Tool

Extending open-account credit terms helps exporters to increase their international sales:

- When customers refuse to pay cash in advance
- By avoiding fees/hassles associated with L/Cs
- As a competitive tactic to outbid other suppliers
- When introducing new products/technologies
- By facilitating negotiation of larger order quantities
- When setting up or expanding distribution
- As an incentive to fill local supply chains
- By transferring inventory to customers
- Above all, by helping to open new markets

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Export Credit Risks

U.S. exporters need to extend competitive credit terms to maintain/grow their international sales, but what happens if they don't get paid? Non-payment risks include:

- Customer bankruptcy, receivership, or insolvency
- Protracted slow payment for any number of reasons
- Cash flow problems or balance sheet issues
- Over-anticipated demand or local competition
- General economic conditions (there or in USA)
- Currency fluctuations
- Foreign exchange/transfer controls
- Expropriation and other political risks
- War, strikes, embargoes, trade sanctions

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Export Credit Insurance

How can exporters protect their foreign receivables and be confident of getting paid? With an export credit insurance policy. Principal benefits of this coverage include:

- Risk mitigation: Export credit insurance protects exporters' foreign receivables against commercial and political risks of not being paid by a foreign customer for virtually any reason.
- Borrowing capacity: Export credit insurance facilitates the arrangement of A/R financing by making foreign receivables attractive to banks and other lenders.
- Sales growth: Export credit insurance helps exporters penetrate new markets that might otherwise be perceived as too risky for extending open-account international payment terms.

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Spreads of Risk

All of an exporter's foreign receivables can be insured under a multiple-buyer policy, or single-buyer cover may be available.

- Whole-turnover coverage
  - Lowest premium rates
  - May include discretionary credit limits
- Key-buyer policies
  - Requires disciplined selection
  - Smaller buyers excluded from premium
- Single-buyer insurance
  - Highest premium rates
  - Buyer needs to be very strong

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Eligibility

Sales of all types of products and services can be covered, in some cases regardless of content or country of origin.

- Ex-Im Bank policies
  - Can cover highest-risk markets
  - Advantages for small-business exporters
  - Only for products manufactured in USA
- Private-sector export credit insurance
  - No USA content requirements
  - Minimum annual premium costs
  - No mandate to help smaller exporters
- Global or domestic coverage is also available

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How Much Does Coverage Cost?

- Premium rates are based on a number of factors:
  - Payment terms extended
  - Spread of buyer and country risks
  - Previous export credit experience
- The cost of export credit insurance is low:
  - Typically a fraction of one percent based on covered sales volume
  - Premiums are usually paid annually or monthly (“pay-as-you-go”)
  - In most cases less than fees charged for letters of credit
- Whether or not the cost is passed to foreign customers, the price of the coverage is insignificant compared to the business to be won by extending competitive credit terms.

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Export Credit Decisions

- Foreign customers don't need to be huge corporations or government agencies to be eligible for coverage
- Any buyers can be considered as long as they are credit-worthy, as determined by one or more of the following:
  - The exporter's previous experience
  - Trade credit references from other suppliers
  - Credit bureau reports
  - Financial statements
- The larger the buyer credit limit requested, the greater the amount of info required

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Underwriting Buyer Credit Limits

- Some insurance companies perform their own credit investigations and analyses of buyers, individually underwriting each foreign buyer for the exporter.
- Others entrust, and even rely upon, the experience and expertise of the exporter to make its own credit decisions, either on the basis of the exporter's own review of the buyer's credit information or its own ledger experience.
  - Named buyer credit limits
  - Discretionary credit limits
    - Based on credit information
    - Based on ledger experience

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Sources of Credit Information - 1

- Trade supplier credit references
  - Obtain and check as many as possible
  - Ideally from suppliers in countries with hard currencies
- Financial statements
  - Reliability varies from country to country
  - Audited statements may not always be available
- Bank references
  - Not available from banks in all countries
  - Information may be too general to be useful
- Time in business
- Local reputation, market share, etc.

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Sources of Credit Information - 2

- Personal visits
  - Relationship development may be more significant than in USA
  - Key for establishing baseline vs. future developments
  - Personal connection essential before later "collections" visits
- Industry-specific creditor groups
  - May provide inside information on customers
  - Source of valuable market information
- On-line, legal, news-wire info
  - May or may not provide info on specific customers
  - Increasingly useful for assessing market conditions
- Juxtaposition of all of the above

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Claims

- Policies are structured so claims may be filed on the basis of either shipments or losses during the policy term.
- Some policies allow claims to be filed as soon as a buyer defaults on payment; others specify a waiting period.
- Most kinds of coverage provide for an optional extended period of time during which the exporter can try to work with past-due customers before claims must be filed.
- After the claim is paid, all receivables from the buyer are assigned to the underwriter.

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Other Ways to Mitigate Risk

- Legal/enforceable documents can reduce non-payment risks and may be critical for effective collections. Bilingual documentation should always be reverse-translated.
- Cash down-payments, partial deposits, and standby letters of credit can of course obviate default risks, but creditworthy buyers may not be prepared to offer them.
- Documentary collections, promissory notes, drafts, or bills of exchange may enhance collection efforts. They do not necessarily reduce underlying credit risk.
- None of these methods of risk mitigation are as effective as export credit insurance.

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Coverage as a Sales Tool

- Increases profitability
  - Makes it more economical for customers to place larger orders
  - Enables negotiation of better pricing from suppliers
  - Facilitates transferring inventory costs to foreign customers
- Supports market penetration
  - Allows opening of new target markets
  - Engenders confidence when selling into high-risk economies
- Gets more out of distributors
  - Enables extended payment terms for distributors
  - Supports negotiation of stronger representation
  - Keeps more products in the local supply chain
  - Increases market share and brand recognition

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Coverage as a Financing Tool

- Enhances borrowing capacity
  - Facilitates the arrangement of favorable A/R financing
  - Makes foreign receivables more attractive to lenders
  - Exporters can assign policy proceeds to their banks
- Strengthens balance sheets
  - Keeps a company's financial position secure
  - Mitigates exposure to unforeseen events
  - Reduces impact of credit risk concentrations
  - Offsets changing international market conditions
  - Allows for reduction of bad debt reserves
  - Facilitates "true sales" of receivables per FASB 140
  - Supports asset securitizations

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- TRADE FINANCE
  - Cross-Border Equipment Financing
  - Foreign Buyer Credit Facilities
  - Note Purchase Agreements
  - Custom Financing Structures

- INSURANCE
  - Export Credit Insurance
  - Political Risk Coverage
  - Domestic Receivables Insurance
  - Policies for Financial Institutions

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