Global Transaction Banking

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Trade Receivables Financing Strategy Relies on Trade Credit Insurance to Mitigate Risk

For many corporations seeking affordable credit in the midst of the current credit crunch, trade receivables financing supported by credit insurance offers an attractive alternative.

Banks' appetite for risk is much reduced compared to this time last year. Because financial institutions nowadays are focusing on lending to corporations that represent higher-quality credit risks, many companies are finding credit availability to be a problem. Meanwhile, even companies with Triple-A credit ratings are seeing the cost of financing rise.

Direct credit facilities from banks, albeit at higher borrowing rates, are still an option for companies that are high-quality credit risks, but companies with less-than-stellar credit might need to look elsewhere for financing.

At the same time, securitizations, which prior to the credit crunch had been a primary source of receivables finance, have become much less attractive, too. Commercial paper investors are only willing to fund the best receivables portfolios, which has driven the price of securitizations dramatically higher.

Insurance Addresses Funding, Risk Issues
Credit insurance addresses the risk and funding issues that have made traditional bank credit facilities and popular securitization methods problematic.

A typical credit insurance policy covers the risk of non-payment related to a company's receivables and makes purchasing or lending against trade receivables much more palatable for banks, particularly in today's environment where bankruptcies and defaults on trade receivables are more common.

Today, for all but those firms with the highest credit ratings, the all-in-cost of trade receivables financing supported by credit insurance is typically less than the cost of bank credit facilities — and much less than most securitization financing.

Strategic Advantages
In addition to providing risk mitigation and facilitating lower borrowing costs, trade receivables financing supported by credit insurance offers a number of advantages:

- Off-balance sheet financing improves a corporation's debt ratios.

- Trade receivables financing backed by credit insurance provides a reliable source of liquidity, because it doesn't rely on capital market funding from sources such as commercial paper investors.

- Foreign receivables are eligible for financing with this strategy.

- Foreign subsidiaries' sales also are eligible for financing. For example, a US company with a subsidiary in Brazil should be able to sell its Brazilian unit's receivables to a bank such as Deutsche Bank, if the receivables are insured. This is an especially important benefit to international treasury groups charged with managing their overseas units' credit costs.

- When the financing involves foreign receivables, the strategy also enables a company to reduce foreign currency risk.

  Let's say a US exporter sells receivables denominated in euros to a bank. That bank will thereafter be assuming the risk that the euros will decline or increase in value relative to the US dollar before the receivables payment is collected. The US exporter no longer bears that risk.

Obtaining Credit Insurance
In volatile markets like we are currently experiencing, credit insurance is proving more available and price stable than other credit risk mitigation vehicles, such as credit default swaps and bank letters of credit or guarantees.

Most trade credit insurance is provided by private insurance companies, domestic and international. In addition, the federal government provides credit risk insurance through the Export-Import Bank of the United States (Eximbank). A sound strategy is to enlist an insurance broker specializing in trade credit insurance to help you find the best provider and rates.