

CREDIT INSURANCE ENHANCEMENTS FOR ASSET-BASED LENDING

Some bank-related tips

The largest current asset on most balance sheets is the Accounts Receivable. It is, as a result, an important element of collateral for many lenders. Enhancing that asset's quality with Accounts Receivable (Credit) Insurance can be a good choice for a bank and for the creditor. If a concentration of risk exists with a small number of buyers, or if a large portion of the A/R asset is to foreign buyers, the bank may require Credit Insurance to mitigate these special risks. Mitigation of risks of non-collection for a creditor can ensure business survival if a large buyer should default.

Bank credit departments often have concerns about how credit insurance works, and, as is the case with any insurance, how well the bank is protected by the policy. An experienced credit insurance broker can assist by pointing out what the major policy compliance issues are, and how the audit and/or borrowing base process can be fitted to monitor compliance with requirements. What follows is a review of some common Credit Insurance policy requirements, and suggestions for monitoring compliance. An Accounts Receivable aging by buyer contains much of the needed information.

Credit Insurance policies have the following features which can affect cover:

- Credit Limits – The amount the insurer is willing to pay for each buyer.
- Reporting – Policies can require a number of different periodic reports from the insured.
- Stop-Shipment – Policies require that shipments stop to a delinquent buyer.
- Claims Filing – A timeline indicating when a claim should be filed.
- Policy assignment – Proceeds of claims payments made payable to bank

Credit procedures can be set to monitor compliance on these issues. Some suggested methods and more detail on requirements follow.

Credit Limits

Policies can have named-buyer limits, which indicate how much the policy will cover for a particular buyer. A copy of the list of buyers and limits, or applicable policy endorsements related to these buyer limits should be part of the bank's information. When a company demonstrates the ability to extend credit and has a successful track record of administering good credit and collection procedures, a policy may be issued with a blanket or "discretionary" limit. If the policy contains such a limit, buyers can be covered up to that limit without being specifically named to the policy. The bank should determine what this limit is, and what internal credit procedures the insured should be using. A broker can assist in identifying and interpreting the credit limit portions of the policy and accompanying requirements.

A comparison of the outstanding amounts for each buyer in the A/R Aging against the applicable credit limit can be readily done, once the matrix of credit limits is established.

As an example, the following chart can be employed:

Discretionary (blanket) limit (requires account be current within 60 days) any buyer.	\$25,000 per buyer
Buyer A Limit	\$100,000
Buyer B Limit	\$500,000
Buyer C Limit	\$1,500,000

With such a chart, each outstanding amount in the aging can be compared with the applicable limit, and included in the borrowing base, if qualified.

Reporting

Periodic reports are part of many policies. A broker can identify the reporting requirements in the policy, due dates, and information content. Having the borrower provide a copy to the bank is a good way to be sure the report has been filed. Some examples of reporting requirements are:

Monthly reports of sales by buyer: Often premium payments must also accompany such reports. Checks should be made against the actual sales (again, the current portion of the aging will contain this information); to be sure all sales are reported as required.

Quarterly reports: These can include a) a gross sales amount (single number) for the quarter, b) a receivables aging, c) a list of accounts and amounts more than 60 or 90 days past due. Policy compliance can be monitored by requiring that a copy of such reports be provided to the bank.

Stop-Shipments

Just as banks do not want to lend against seriously past-due receivables, insurers do not want to insure additional sales to a seriously past-due buyer. Policies contain language that indicates how many days past-due a buyer can be before shipments must stop. A broker can help identify this language in the policy, and again, an aging of A/R by buyer can be examined to assure that no further shipments have taken place to a seriously past-due buyer.

Claims Filing Window

Policies have different claims procedures. One important element is when a claim should be filed. There is often a first day the claim can be filed, there is usually also a final day that a claim can be filed. In the event of a buyer default, the bank's audit process should include making sure that a claim is filed on time. A broker can assist in identifying the claims filing requirements, and when a claim should be filed. Supporting documents like bills of lading, invoices, and purchase orders are usually required to document the buyer obligation in the event of a claim.

Policy Assignment

Insurers are willing to pay the proceeds of a claim directly to a lender, as long as this is approved in advance. The procedure for assigning the proceeds of a claim to the bank are usually fairly simple, and differ slightly, depending on the insurer. A broker can assist in providing the appropriate forms and procedure for establishing an assignment of proceeds.

Checklist

Here is a checklist of policy compliance elements that can serve as a framework for establishing the status of insured accounts receivable:

Credit Limits	What are the named buyer limits? Is there a blanket or discretionary limit? What is the amount? Check Aging by buyer against limits
Reports	When are reports due? What is the required content or form? Did the borrower provide a copy of the report as required?
Stop Shipments	How many days past-due can a buyer be before shipments must stop? Check aging by buyer against this requirement
Claims Filing Window	Are any buyers in default? What is the first day to file a claim? What is the last day to file a claim? Flag all buyers in default and check against this window.
Policy Assignment	Are the policy proceeds assigned to the bank? Does the bank have a copy of the document that establishes the assignment?

This information is designed to serve as a primer on the subject of Credit Insurance policy compliance and monitoring, and is not exhaustive. Each policy is different. A good first step is to work with a qualified credit insurance broker who can review the unique requirements of your borrower's policy.

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