



**POSITION PAPER** issued by International Credit Insurance & Surety Association



# **RECOMMENDED CONDITIONS FOR TRADE CREDIT- INSURANCE TO BEST SUPPORT THE ECONOMY**

To whom it may concern, notably but not limited to:

governments, administrations, insurance regulators, industry associations, business leaders, other economic influencers.



## Background

### What is trade credit insurance?

Trade credit insurance insures manufacturers, traders, and service providers against the risk that their buyer does not pay (following bankruptcy or insolvency, for example) or pays very late.

The trade credit insurance policy will pay out a percentage of the outstanding debt (e.g. 90%). In the absence of trade credit insurance, many trade transactions would have to be done on a pre-paid or cash basis, or not at all.

Trade credit insurance often includes a number of services (information on buyers, risk monitoring, and debt recovery, among others) that makes it a gradually comprehensive credit management tool.

### What is ICISA?

The International Credit Insurance & Surety Association (ICISA) is the global industry association of private credit-insurance companies. It provides a forum for the continuous exchange of ideas and information, in order to

support improving and developing the specialised services its members provide for the business world.

This includes the exchange of views and experience about trading conditions and developments in particular industrial and trade sectors as well as markets, the exchange of information about credit risks and co-operation through reinsurance arrangements. ICISA also supports the promotion of credit-insurance and surety products through information of the public and cooperation with other industry associations.

The Association has members located on all five continents insuring risks in practically every country in the world.

### How does trade credit insurance serve businesses?

Suppliers that deliver goods and/or services on credit have to manage this credit risk, to ensure that payment is received on time. Outstanding receivables are usually the largest- or second-largest item on a trading company's

balance sheet. Bad debt losses can affect liquidity and profits. Even worse, they can spell a company's mean financial ruin. By insuring these receivables against non-payment or late payments, the company ensures its cash flow and its profit. As such, credit-insurance contributes to reinforcing the own rating of the company (if it has one) and to reassuring all its financial partners.

The value of Trade Credit Insurance cover was demonstrated during the financial crisis, during which insured manufacturers and traders saw their losses on defaulting buyers reimbursed. In 2008 and 2009, the industry paid out claims exceeding EUR 9 billion to its insured policyholders (source: ICISA annual reports). Many of these policyholders would not have survived without Trade Credit-Insurance compensation.

Meeting precautionary obligations, managing credit and hedging risks - using Trade Credit-Insurance is in line with the legal obligations incumbent on a company's

executives. Trade Credit-Insurance is a first rate financial instrument for hedging risks, preventing also the risk of class claims.

As a risk knowledge and protection instrument, Trade Credit-Insurance enables businesses to enter new markets or to start new distribution channels.

Trade Credit Insurance is also commonly leveraged to meet financing needs, as banks may lend more capital against insured receivables and in better financing terms.

### **How does Trade Credit-Insurance support the economy**

From a macroeconomic standpoint, trade credit insurance lifts barriers against the well-known insolvency domino effect, whereby suppliers go bust because one of their clients is insolvent. On average, one-in-four cases of insolvency are due to an unpaid debt.

Credit-Insurance serves as a supporting instrument for intercompany credit facilities, which constitute the largest and most liquid instrument in short-term financing (far above bank instruments in value). In some distribution sectors, it is crucial for well-capitalised manufacturers to fund the stock of their equity-light distributors.

For exportation, the contribution of trade-credit insurance to the economy of a country is a must. Proof of this can be seen in the number of export credit agencies historically created by governments to support their exporting companies until the private market could bring this insurance capacity. Today, exporting from a country where no credit insurance is available – whether private or public – means competing on the global market at a heavy disadvantage. 

# Recommendations put forward by ICISA

As a regulated product, Trade Credit-Insurance is dependent on certain rules and conditions, which might, in some instances, reduce the benefits to businesses and the economy in general. This position paper aims to provide some recommendations to let the plain benefits of trade credit insurance be delivered. This paper does not express a general opinion against the principle of regulation, which is acknowledged by ICISA as an essential backbone for the credibility and the solidity of this industry.

## Credit risk information

For the sake of underwriting the risks, credit insurers need to access financial information about the clients of the insured party. For export transactions, this information often concerns faraway overseas buyers. Trade Credit-Insurance, as an industry, requires free and flexible sourcing and processing of information. Such information is generally handled confidentially. In this sense, it is of a very different nature to public rating services, which are now the object of specific regulations in many countries. By not facilitating such access to information for trade credit-insurers, decision makers would make risk monitoring less effective, insurance less cost-effective, and would ultimately reduce the benefit to their economy and/or put their exporters at a competitive disadvantage compared with exporters from other countries.

**ICISA recommends allowing regulated trade credit insurers to process financial information without any restrictions other than that the outcome may not constitute a public rating.**

## Recovery of trade receivables

Credit insurers typically assist companies in recovering their unpaid debts, with both a view to mitigating the claims charge, as well as a side benefit for companies

in respect of the uninsured portion of the debt. As such, credit insurers are de facto distributing global debt collection services in the framework of their insurance offering. To collect foreign debts, they either use their own local resources or a network of local debt collection agents. This handling of unpaid debt is often heavily processed and supported by information technology.

**ICISA recommends allowing regulated credit insurers to act as collecting agents, or as the case may be, to limit the requirements to the provision of a surety bond to guaranty the funds collected on behalf of the insured company.**

## Reinsurance

Like most insurance lines, trade credit insurers use reinsurance to mitigate the risks they insure on their own balance sheet. The recourse to reinsurance is fundamental for three reasons:

- trade credit risk is correlated with the economic cycle: for facing severe economic crises, the specialized industry is more robust by reinsuring with reinsurers who blend credit risk among other lines of business
- an accumulation effect exists with very large distribution counterparties from the real or the digital economy: in order to bring the necessary risk capacity to the economy, the actors need the support of reinsurance
- an accumulation effect exists on countries in connection with political risk cover

The reinsurance market is a global market which resolves the accumulation /concentration problems by organising cross-continental mutualisation of risks. The regulations aimed at reducing outward revenue flows by limiting the recourse to foreign reinsurance cause a problem for a specialty line like credit insurance, where local reinsurance



capacity is always too scarce to cover the needs of the local market. Scarcity may come from the financial capacities or from the number of reinsurers having the expertise to underwrite trade credit risk.

**In order to provide the risk capacity that supports the development of the local economy, ICISA recommends letting trade credit insurers source their reinsurance with the global market, without limitation in percentage or local content considerations.**

#### **Fronting**

Specialized trade credit insurance companies may need or wish to offer their services in a country where they have not yet applied for a licence. In all countries where trade credit insurance is not allowed without a licence, this can only happen by setting up a fronting partnership with a locally-regulated insurer. Such a partnership would generally embrace 3 dimensions: risk-sharing (the local frontier is reinsured by the foreign specialized carrier), knowledge

sharing, and possibly distribution. The advantage for the local economy is obvious, as fronting agreements:

- accelerate the maturity of the local players,
- increase the number of options made available for businesses at a quicker rate, and
- increase the risk placement capacity made available to the local economy.

However it requires two conditions: first, that external reinsurance is possible, and second, that the foreign specialist be allowed to render its services in the country (just the services, not insurance).

**ICISA recommends that foreign specialist credit-insurers be allowed, in the frame of a fronting scheme, to provide:**

- reinsurance to local regulated insurers
- the associated services to the businesses insured (risk monitoring, debt-collection, online tools...)



**Flexible underwriting (wording, pricing)**

A few regulators have elected to set terms and conditions for credit insurance, either through a compulsory policy wording or through a unique pricing pattern. Although the ambition is certainly to protect the insurance takers against unfavourable policy terms or inappropriate pricing, it may translate into a significant drawback to the economy. As a matter of fact, trade credit insurance is an instrument that supports trade transactions in all their forms, practices and sometimes complexity. By implementing rigid frames on wordings and prices, such regulators place businesses in a “take it or leave it” situation, whereas their competitors from other countries may have access to the appropriate insurance solutions.

**ICISA recommends that trade credit insurance be operated with free wording and pricing principles, which does not prevent a certain level of control through policy filing or disclosure obligations.**

**Insuring the receivables ceded to a financing party**

Trade receivables often constitute an interesting financing support, because it is a well-diversified asset and in some instances the counterparties may have a stronger financial rating than the receivable owner itself. Trade credit-insurance is able to facilitate trade receivables financing by bringing protection against non-payment by the debtors.

Following the 2008/09 crisis, and the suspicion against sophisticated schemes involving multiple retrocessions of risks (like in certain securitizations), some regulators decided to prohibit insuring the trade receivables acquired by a financing institution. This cancels the possibility to use credit-insurance and all the risk knowledge that comes with it to consolidate such financing schemes. Contrary to some complex securitization structures, Trade Credit-

Insurance-backed financing consists in ceding the credit risk to the best expert on that risk. It does consolidate the financing instrument and helps avoiding unexpected systemic patterns.

**ICISA recommends that the first financing party be authorized to insure the acquired receivables against non-payment with specialized trade credit-insurers.**

**International programs of credit-insurance**

Multinational corporates tend to buy insurance through international programs, whereby risk placement can be optimised at a larger scale and services can be sourced more cost-efficiently. Operating such international programs requires some flexibility on many levels that are already indicated in the above sections. On top comes the issue of the link created between contracts located in different countries by the means of ‘group clauses’.

For instance, providing a ‘group liability’ (as opposed to individual liabilities for each policy of the program) comes at the advantage of the insured party due to the economy of scale. However, it implies that the contract execution in one given country is made dependent upon insurance events taking place in another contract/country/jurisdiction. Some regulators do not authorize these extra-territorial links.

**ICISA recommends that large corporates and their subsidiaries be granted the possibility to purchase a local policy in the frame of a larger insurance program, the provisions of which may affect the execution of the local policy by the means of group clauses, on the condition that such provisions are clearly and transparently explained in the local policy and are not kept confidential to the local policy holder.**





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