RISK MANAGEMENT

Biz rushes for insurance against dodgy customers

Coverage for receivables is coveted just when insurers cut back or charge higher premiums. Prices up as much as 20% in past year.

By Beth Braverman

LAST YEAR, JON LAUBSCHER handled maybe 10 claims for trade credit insurance at Wells Fargo Insurance Services. "Now, I have more claims than that open on my desk right now," said Mr. Laubscher, west region product team leader, Trade Credit & Political Risk.

Claims under trade credit insurance, a rarely used type of insurance that covers companies' receivables losses stemming from bankrupt customers, have skyrocketed over the past year. So has corporate interest in the product, industry experts said, as companies face mounting bankruptcies and increased calls for more generous credit terms. Demand is particularly strong among companies that depend on only a few customers for much of their revenue.

But even as demand for trade credit insurance has increased, its availability has declined and premiums have shot up, especially for companies in hard-hit industries such as retail, automotive, home building or aviation. Insurance experts say premiums have risen 10% to 20% over the past year.

"Before [the economic downturn], our premiums were lower and our appetite for risk was higher," said Rick Ostopoqicz, a spokesman for Euler Hermes ACI, North America's largest provider of trade credit insurance.

Nevertheless, the Allianz subsidiary has seen a more than 40% increase in new applications for credit insurance in the first 10 months of 2008. Claims have increased even faster, growing about 50% in the same period.

Almost 10,000 businesses filed for bankruptcy in the second quarter, a 45% increase over the same period in 2007 and double the amount in 2006, according to the

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Hot stuff: Insurance for receivables

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American Bankruptcy Institute. The credit crunch has forced even healthy companies to squeeze their suppliers for additional credit in the form of larger credit lines and later payment due dates. Customers that used to settle accounts in 30 days are now asking for 90 days.

"That's a very long time to have receivables out there without coverage," Mr. Ostopoqicz said.

The increased demand for the coverage reflects a heavier emphasis among companies on protecting their balance sheets and income statements, along with growing demands from asset-based lenders that borrowers have such insurance to guard their receivables, experts said. Costs range from 15 basis points to 35 basis points per $100 in sales, according to insurance pros. Still, not all companies believe the coverage is worth the hefty price.

"It seems like the insurance companies will insure the receivables for customers with good credit, but not the riskier ones," said Cheryl Ajax, an accountant with E.J. Ajax & Sons, a metal stamping company in Minneapolis, Minn. "So what's the point of that? It's too much money."

But Ms. Ajax has begun monitoring the company's receivables more closely and, so far, has resisted calls from customers for more generous credit terms.

While about 40% of companies in Europe carry trade credit insurance, it is still a relatively underutilized product in the United States, with about 10% of companies using it, said Gary Mendell, president of trade credit broker Meridian Finance. Before the economic downturn, the product primarily appealed to growing companies who wanted greater protection against the increasing risks posed by more or larger credit customers.

ROUGHLY 40% OF EUROPEAN COMPANIES CARRY TRADE INSURANCE, BUT IT'S UNDERUTILIZED IN THE U.S.

Even as more companies begin looking for trade credit insurance, underwriters have discontinued coverage of credit to companies at increasing risk of bankruptcy. Insurers with existing policies covering such accounts will honor them, but they have begun declining additional coverage in the sector.

"If you come in looking to insure receivables for an account, for example, for a name retailer or a company in the automotive sector, at this point, you can't always get coverage because the capacity just isn't there anymore," Mr. Mendell said. "Companies that apply for credit insurance now because they think their customers are in bad financial shape are unable to find any insurance company that will underwrite them."

The minimum trade credit insurance premium for smaller companies starts at about $20,000 and averages about $25,000, double the minimum premium cost last year, Mr. Laubscher said. Insurers have been progressively reining in the amount of risk they're willing to write since last year, he added.

Despite the price increase, Wells Fargo's Mr. Laubscher said he fields nearly a dozen calls a day from customers interested in finding out about trade credit insurance, about twice as many as a year earlier.

Companies that want to continue extending credit to risky buyers but can no longer find insurance may be able to turn to the capital markets to protect their risk—at a cost.

Dawson Beattie, director for financial products for credit in the securities investment group at Wells Fargo, sells companies puts on their accounts receivables with risky companies. But prices for those products have increased 100% in the last three months alone.

"Basically," he said, "you're buying [coverage] for a name that everyone knows is at risk—and you're paying for that risk." FW