Insurance of International Trade Risks

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Course Structure

Date	Topic	Tasks
Sept' 07	1. Risk management in the international foreign trade operations	- Currency risks management - SWOP operations discussion
Sep' 14	2. International cargo and marine insurance	Role play: International cargo insurance (rates estimation and handling claims)
Sep' 21	3. Insurance of international investments and credits	Presentations
Sep' 28	Pass/fail Examination	

Recommended bibliography

In Russian

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Чунтомова Ю.А. Транспортное страхование. М.: ТрансЛит, 2008

Шинкаренко И.Э. Страхование ответственности : справочник. - 2-е изд., испр. и доп. - М.: Анкил, 2006. - 416 с.

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Экспорт товара: купля-продажа, перевозка, страхование, банковские сделки, Кокин А.С.,Левиков Г.А, Издательство Спарк, 2005

In English

Managing Risk in International Business. Ephraim Clark, Bernard Marois. Thomson Business Press, 1996

The Handbook of International Trade and Finance: The Complete Guide to Risk Management, International Payments and Currency Management, Bonds and Guarantees, Credit Insurance and Trade Finance, Anders Grath. Kogan Page. 2008

Web resources

1. Российский портал страховой индустрии http://www.allinsurance.ru
2. Сайт Всероссийского союза страховщиков http://www.ins-union.ru
3. Сайт, посвященный особенностям морской перевозки. Содержит интересные тематические справочники http://www.transrussia.net
4. Информационная платформа для всех участников транспортного рынка. Статьи по проблемам страхования. http:/www.seanews.ru
5. Портал, посвященный перевозкам грузов, в т.ч. международных, различными видами транспорта www.mezhtransavto.ru
6. Freight Transport Association http://www.fta.co.uk/
7. Insurance information institute http://www.iii.com
8. Swiss Re Portal www.swissre.com
9. Lloyds of London http://www.lloyds.com/
10. International Underwriting Association of London http://www.iua.co.uk/

1. Risk management in the international foreign trade operations

Risks in International Trade

Economic risks	Risk of concession in economic control Risk of insolvency of the buyer Risk of non-acceptance
Financial	Risk of default i.e. the failure of the buyer to pay off the due amount after *n-months* of the due date Risk of Exchange rate
Commercial risk	A bank's lack of ability to fulfill its responsibilities A buyer's failure pertaining to payment due to financial limitations A seller's inability to provide the required quantity or quality of goods
Political risks	Risk of non- renewal of import and exports licenses Risks due to war Risk of the imposition of an import ban after the delivery of the goods Surrendering of political sovereignty
Buyer Country risks	Exchange control regulations Lack of foreign currency Trade embargoes

Risk Management Tools

Loss Control

Loss reduction activities

Loss prevention activities

Loss Avoidance

Loss Financing

Retention and self –insurance (reserves)

Loss Transfer

Insurance

Hedging

Other contractual risk transfers

Internal Risk Reduction

Diversification

Investments in the information

Most popular risk management instruments

-A documentary letter of credit

offers the best protection for overseas commercial transactions

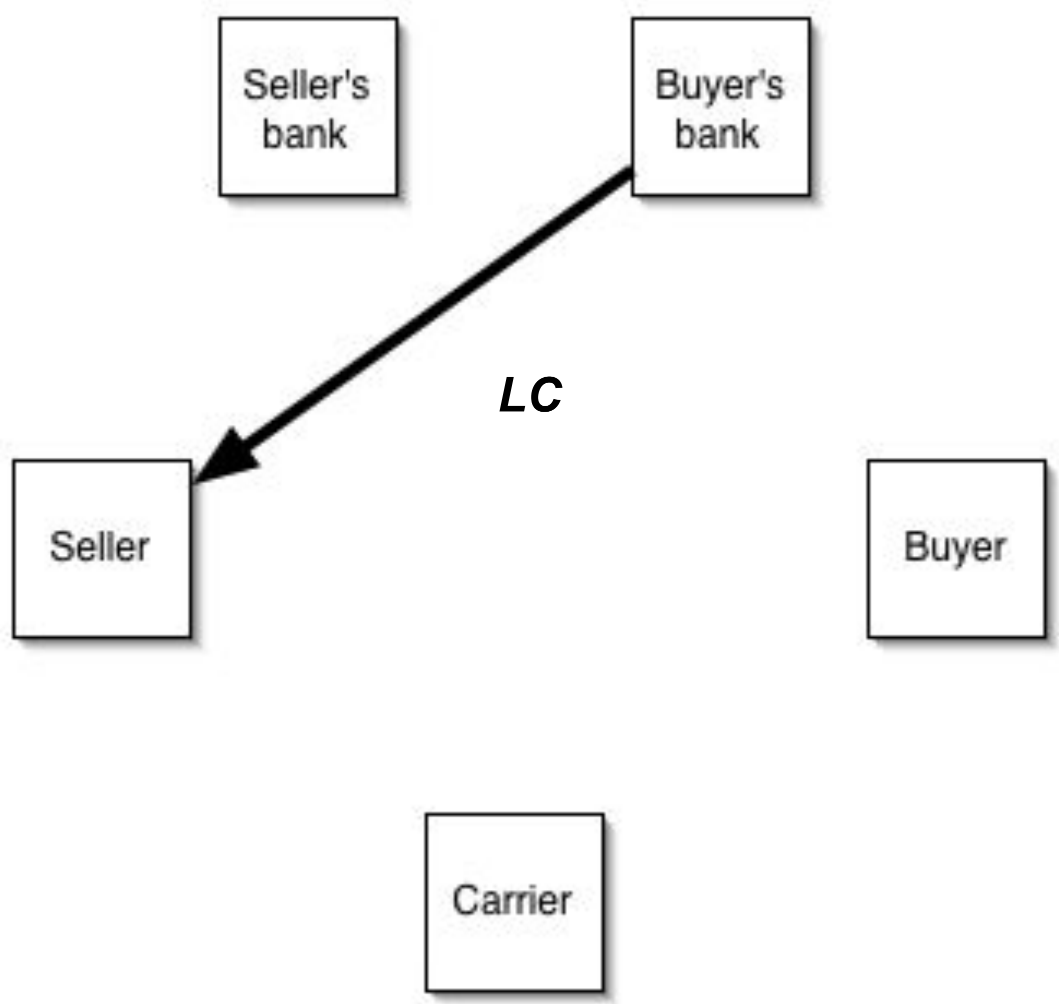
-The correct derivatives guarantee

cover against the exchange rate exposure

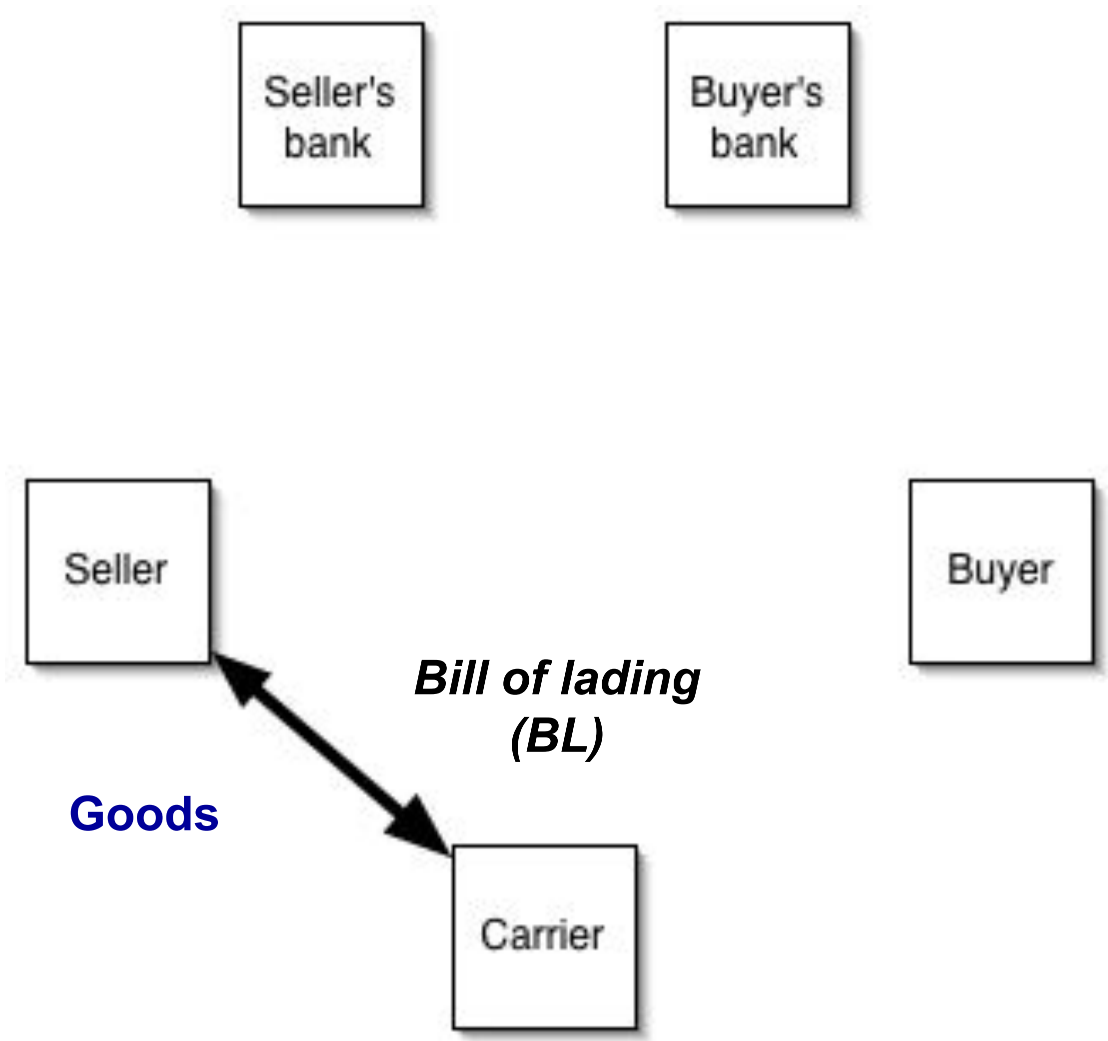
How a documentary letter of credit works?

1. A documentary letter of credit is opened by the purchaser's local bank (the credit-opening bank).
2. Via the credit-transmitting bank, the documentary letter of credit reaches the vendor. It checks whether the terms of the documentary letter of credit match the terms of your commercial contract. Only if the vendor is convinced can he send the goods to the purchaser.
3. The necessary documents (invoice, transport document, insurance documents) are handed over by the vendor to the credit-transmitting bank. After checking these documents, the credit-transmitting bank pays the sum that the purchaser owes to the vendor directly.
4. The credit-transmitting bank sends the documents to the credit-opening bank that, after checking the documents in turn, pays the amount due to the credit-transmitting bank.
5. Via the credit-opening bank, the documents finally reach the purchaser, who can use these documents to collect the shipped goods.
6. Finally, the buyer pays the amount owed to the local bank.

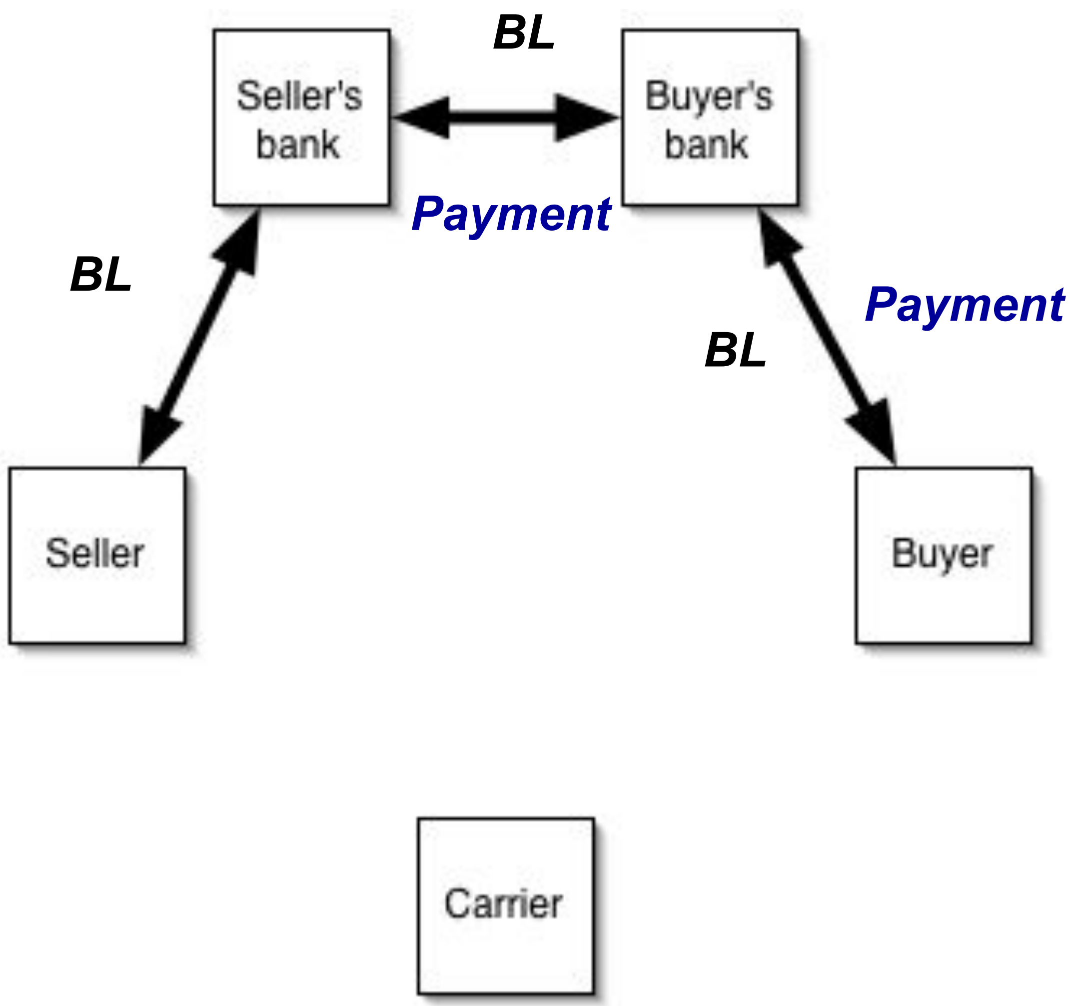
1. After a contract is concluded between buyer and seller, buyer's bank supplies a letter of credit to seller



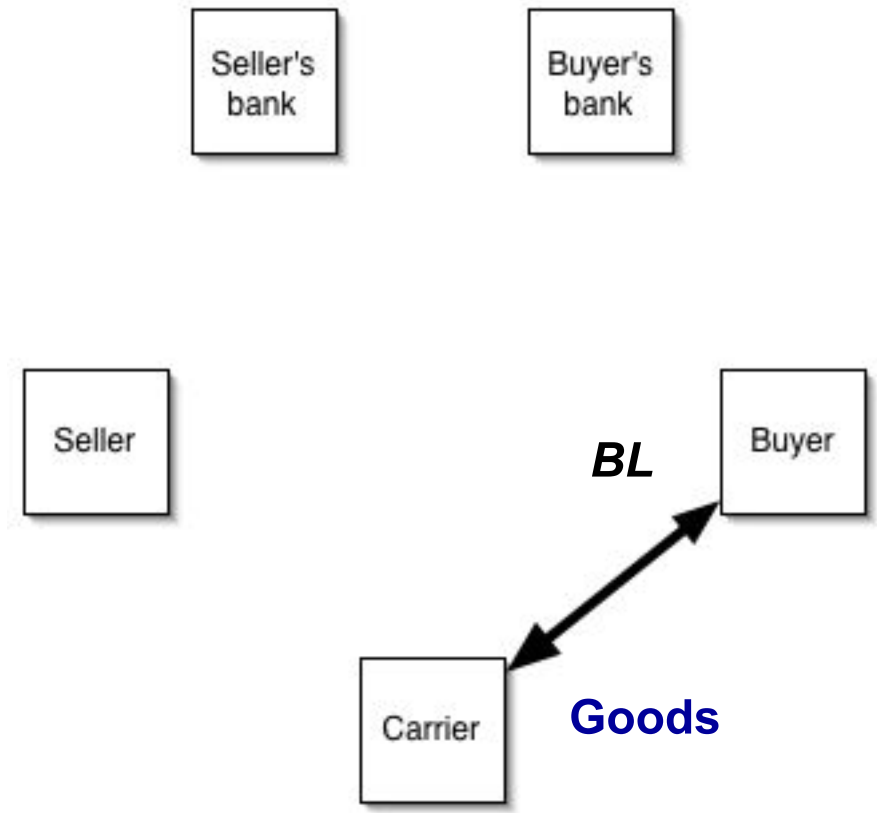
2. Seller consigns the goods to a carrier in exchange for a bill of lading



Seller put bill of lading for payment from buyer's bank. Buyer's bank exchanges bill of lading for payment from the buyer.



Buyer provides bill of lading to carrier and takes delivery of goods



Exchange rate exposure

You make **forward purchases of foreign currencies** and wish to protect yourself against unfavourable trends in the foreign currencies that you have to buy.

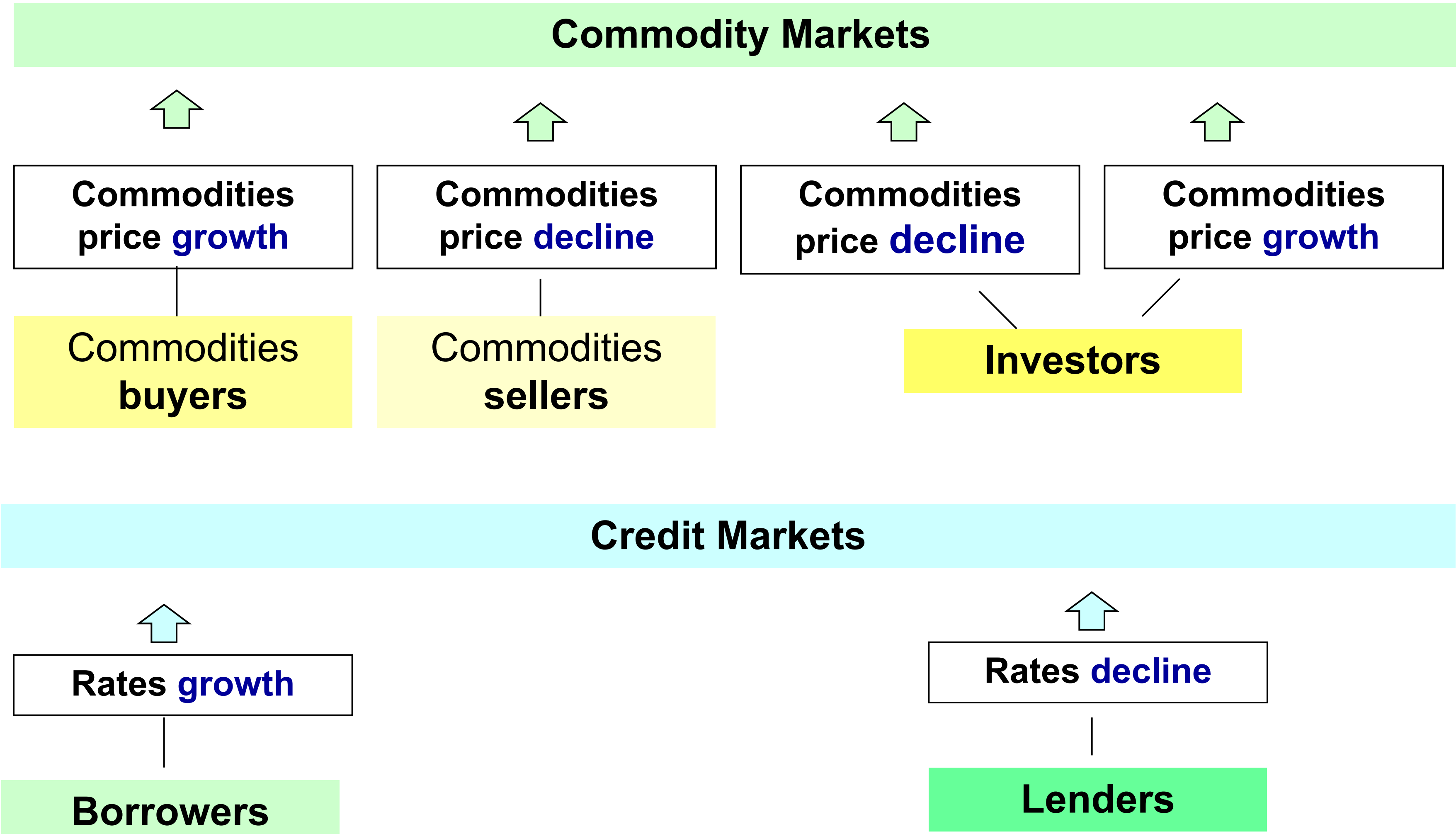
You make **forward sales of foreign currencies** and wish to protect yourself against unfavourable trends in the foreign currencies that you have to sell.

Participants of the financial markets and their interests

Currency Markets

Foreign currency exchange rates growth	**Foreign currency exchange rates decline**	**Foreign currency exchange rates growth**	**Foreign currency exchange rates decline**
Buyers (importers)	**Sellers** (exporters)	**Borrowers** (in foreign currency)	**Lenders** (in foreign currency)

Participants of the financial markets and their interests



Currency appreciations and depreciations

Previous Exchange Rate (X): Currency A/ Currency B

Current Exchange Rate (Y): Currency A/ Currency B

If X > Y (X – Y > 0), Currency A has appreciated and Currency B has depreciated, relative to one another

If X < Y (X – Y < 0), Currency A has depreciated and Currency B has appreciated , relative to one another

Foreign currency exchange rate risks

Translation risks

Arising from the ownership of operating companies outside the home country. The greater the proportion of asset, liability and equity classes denominated in a foreign currency, the greater the translation risk.

Transaction risks (contractual risks)

Arising from the time delay between entering into a contract and settling it. The greater the time differential between the entrance and settlement of the contract, the greater the transaction risk, because there is more time for the two exchange rates to fluctuate

Non contractual risks

Arise because exchange rate fluctuations can affect the competitive position of the firm

Minimizing contractual risks

Example: UK based company buys property in USA for $ 440 mln. Payment delayed for **2 month.**

Method 1. Borrow GBP, convert proceeds to USD and invest dollars until needed

	Cash Flow, mln	
	£	**$**
Now: **Borrow £ 248,6 m. at 13%**	**+ 248,6**	
Convert to $ at $1.743/ £	**- 248,6**	**+ 433,3**
Invest 433,3 m for 2 months at 9,7%		**- 433,3**
Net cash flow	***0***	***0***
Month 2 **Repay £ loan with interest**	**- 253,7**	
Receive payment on $ loan		**+440**
Pay for properties		**- 440**
Net cash flow month 2	***- 253,7***	***0***

Minimizing contractual risks

Method 2. Buy dollars forward

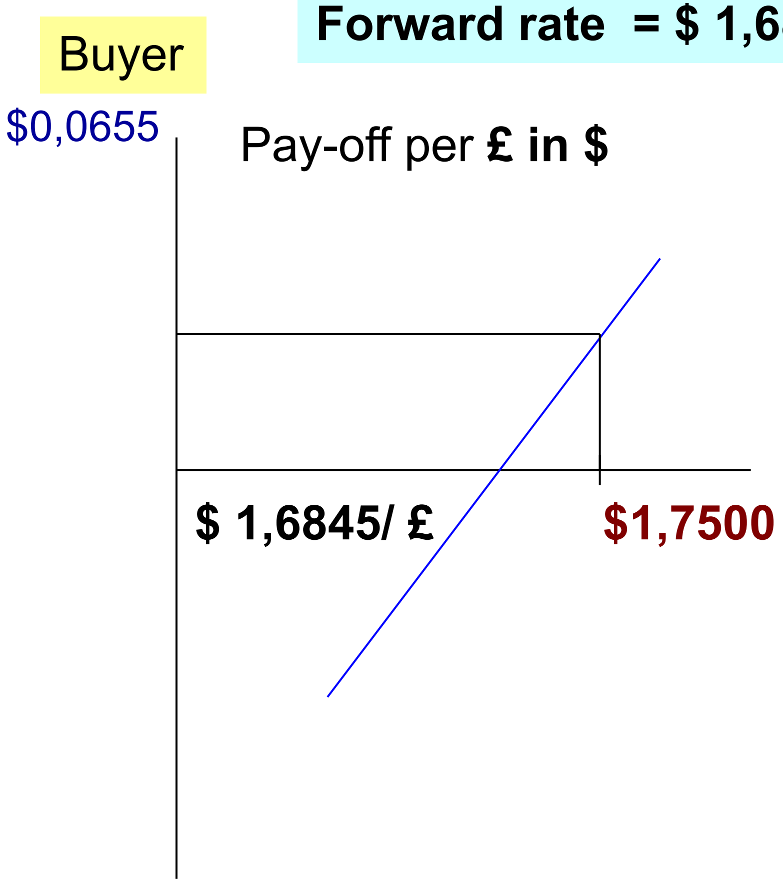
	Cash Flow, mln	
	£	$
Now: **Buy $ 440 m forward at $1.73 / £**	**0**	**0**
Month 2		
Pay for $	**- 254,3**	**+440**
Pay for properties		**- 440**
Net cash Flow month 2	***-254,3***	***0***

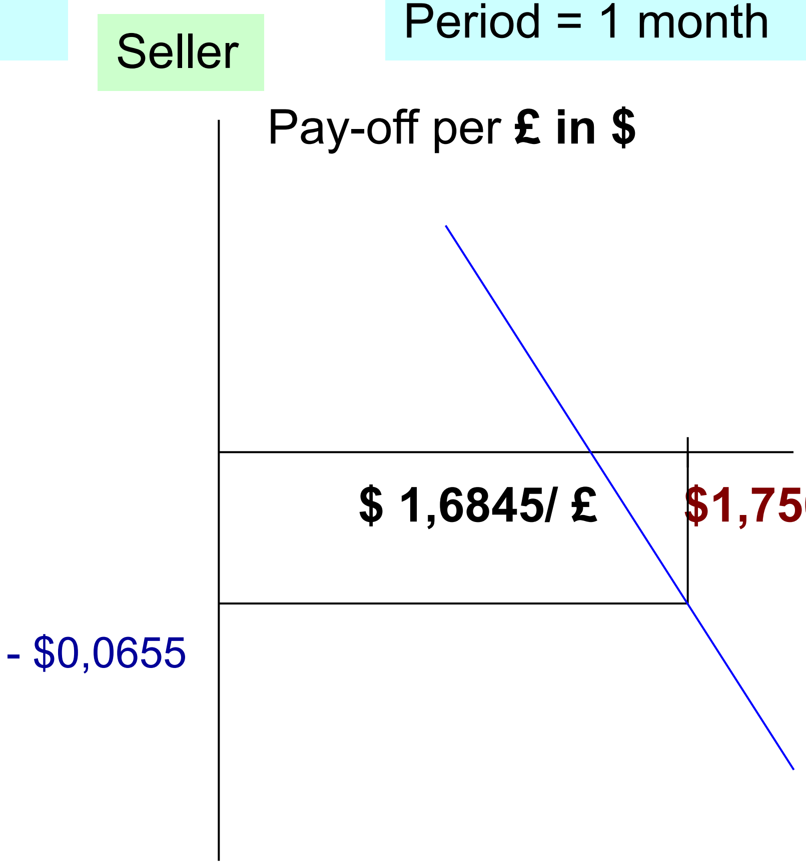
Cost of hedging = Forward rate – Expected spot rate

Currency forward contracts and rates

Forward rate = $ 1,6845/ £

Period = 1 month





Forward premium

Fair Forward Exchange Rate

= **Spot rate** * (**1**+ **R** for) / (**1**+**R** home)

where,

R for – risk free rate abroad

R home – domestic risk free rate

Suppose, current spot on SFr is **$0,5800 / SFr** (or SFr 1,7241 /$)

1 year risk free rate for borrowing in SFr = 5%, in USD = 6%.

One year forward rate = 1,7241 * 1,05/1,06 = SFr 1,7078 /$

Price of Forward Exchange Contract (in %)

= (Forward price – Spot price) / Spot price

Hedging with currency forward contracts

UK company expects to receive SFr 10 mln in 90 days

Spot ex.rate currently = £0.6050/ SFr (SFr 1.6529/ £)

Three month forward rate for SFr = £0.6051/ SFr (SFr 1.6526/ £)

1) If spot declines to **£0.5800/ SFr** what will be effect of hedging?

2) What are costs of hedging for UK company?

SWAPS & Interest rate risks

SWAPS – arrangement by two counterparties to exchange one stream of cash flows for another.

Company issues <u>floating rate bonds</u> (payments = LIBOR * notional principal $100 mln)

LIBOR -? If LIBOR 8,5% company has losses (-500 000)

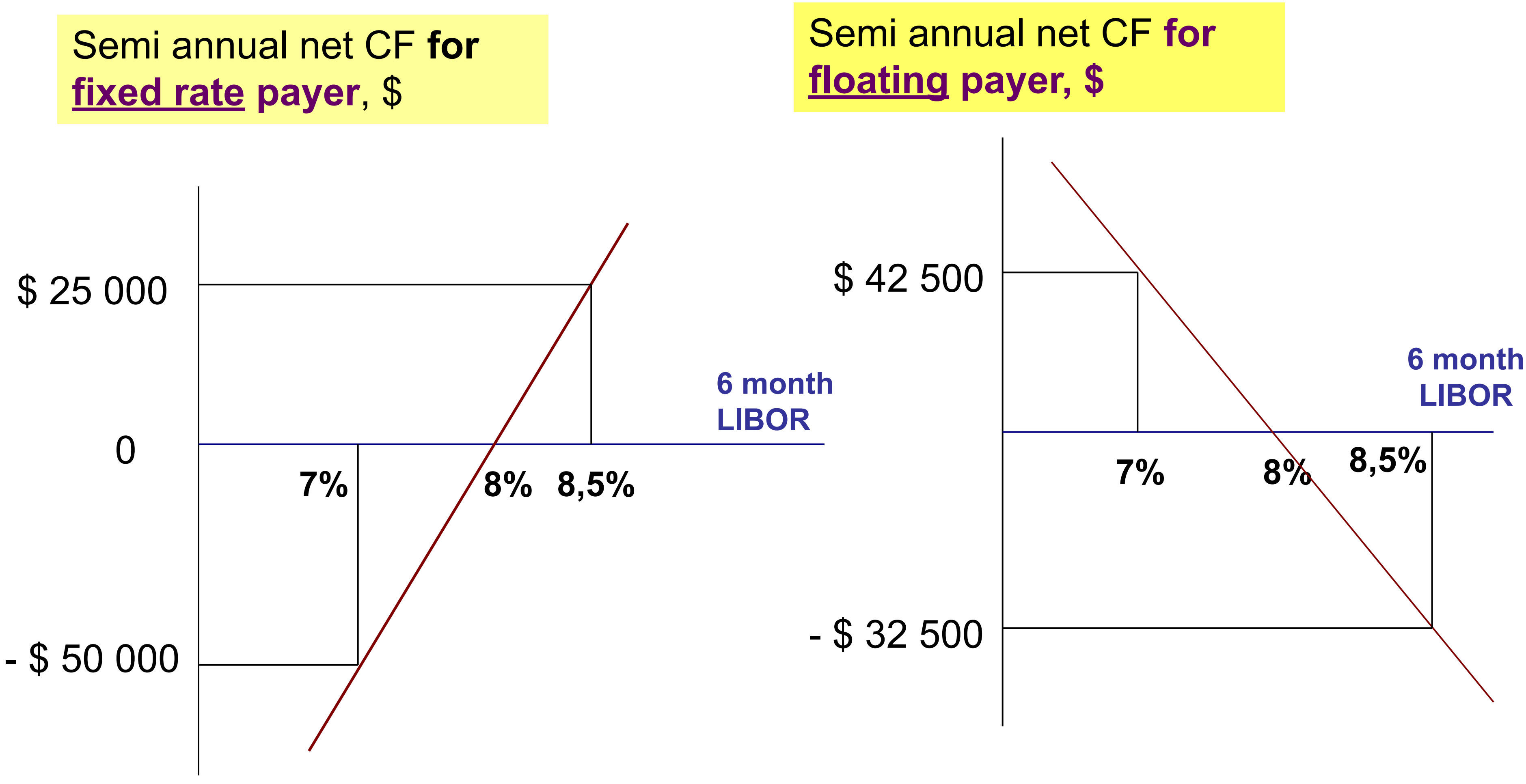
Company has an agreement with dealer to pay LIBOR * 8% if rates <u>less</u> than 8%. Dealer pays LIBOR * 8% if rates <u>higher</u> than 8%.

	London inter bank offer rate (LIBOR)		
	7,5%	**8,0%**	**8,5%**
Interest paid on floating rate bond (= LIBOR * $ 100 mln)	**$ 7 500 000**	**$ 8 000 000**	**$ 8 500 000**
+ Cash payment on SWAP [(= <u>0,08</u> –LIBOR)] * notional principal $100mln	**500 000**	**0**	**-500 000**
Total payment on <u>bond with swap agreement</u>	***$ 8 000 000***	***$ 8 000 000***	***$ 8 000 000***

Interest rate swap can **transform** <u>floating rate bonds</u> into synthetic <u>fixed rate bonds</u>

Fixed for floating swaps

Notional principal = $ 10 mln



Example of currency swap

US based company **A** is going to invest **in Germany in EURO**

Germany based company **B** is going to invest **in USA in USD**

US based company A issues bonds in USA and collects $ 7 mln. to finance deal in Germany

8% rate, 10 years

German based company B issues bonds in Germany and collects € 10 mln. to finance deal in the USA

8% rate, 10 years

Fixed exchange rate
In swap = **$ 0,7/ €**

Fixed exchange rate payer,

US based company A

Intermediary

Fixed exchange rate payer,

German based company B

At the end of 6 months US Comp pays: $ 7 mln. * 0,08 ÷2 = $ 280 000 * **1,7** = 400 000 EUR

At the end of 6 months German Comp pays: € 10 mln. * 0,08 ÷2 = € 400 000 * **0,7** = 280 000 EUR

Risk Hedging, Risk Management and Value

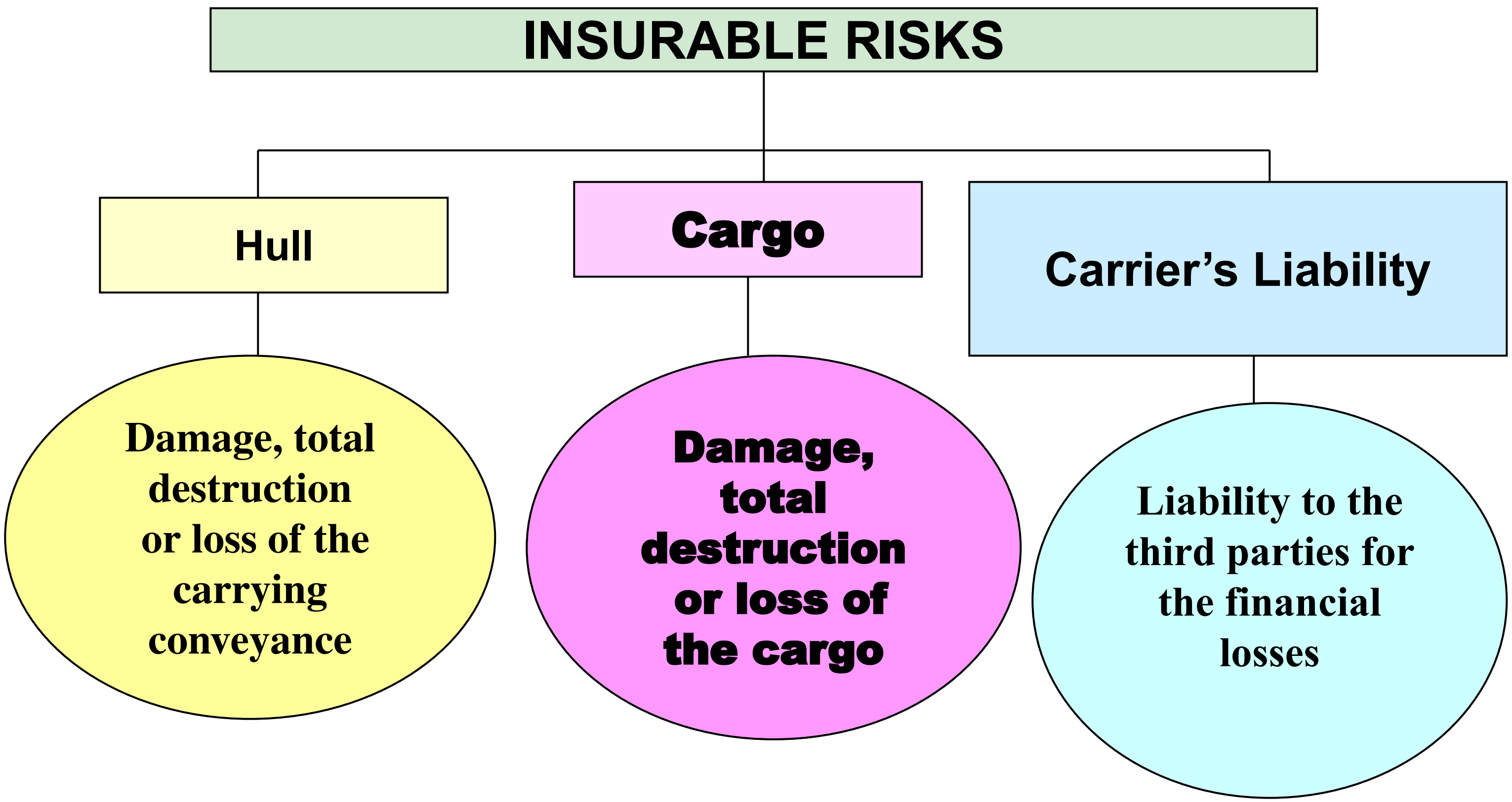
Valuation Component	Effect of Risk Hedging	Effect of Risk Management
Costs of equity and capital	Reduce cost of equity for private and closely held firms. Reduce cost of debt for heavily levered firms with significant distress risk	May increase costs of equity and capital, if firms increases its exposure to risks where it feels it has a differential advantage.
Cash flow to the Firm	Cost of risk hedging will reduce earnings. Smoothing out earnings may reduce taxes paid over time.	More effective risk management may increase operating margins and increase cash flows.
Expected Growth rate during high growth period	Reducing risk exposure may make managers more comfortable taking risky (and good) investments. Increase in reinvestment rate will increase growth.	Exploiting opportunities created by risk will allow the firm to earn a higher return on capital on its new investments.
Length of high growth period	No effect	Strategic risk management can be a long-term competitive advantage and increase length of growth period.

2. International cargo and marine insurance

Plan of the lecture

- Structure of insurance programs
- Forms of insurance agreements
- International Cargo Clauses
- Carrier's liability insurance
- Specific of handling claims

Insurance programs for foreign trade organizations



Who are interested in transportation of cargo insurance?

- **Importers**, buying on FOB & CPT conditions
- **Exporters**, selling on CIF/CIP conditions
- **International traders** (buying in one country and selling to another country)
- **Goods producers**, purchasing raw materials and selling finished goods
- **Distributors**
- **Transportation and Stock Companies**, who has a contract liability to buy insurance for clients' cargo

Forms of insurance agreements

Single insurance policy
/ Разовый полис страхования

Features:

- Valid for one shipping
- Valid for a period from 30 to 60 days from the date of insurance premium payment
- Fact of shipment must be documentary confirmed by the insured
- In case of delay in delivery, insurance premium has to be retuned by the insurer to the client (minus insurance loading)

Open cover /
Генеральный полис (договор) страхования

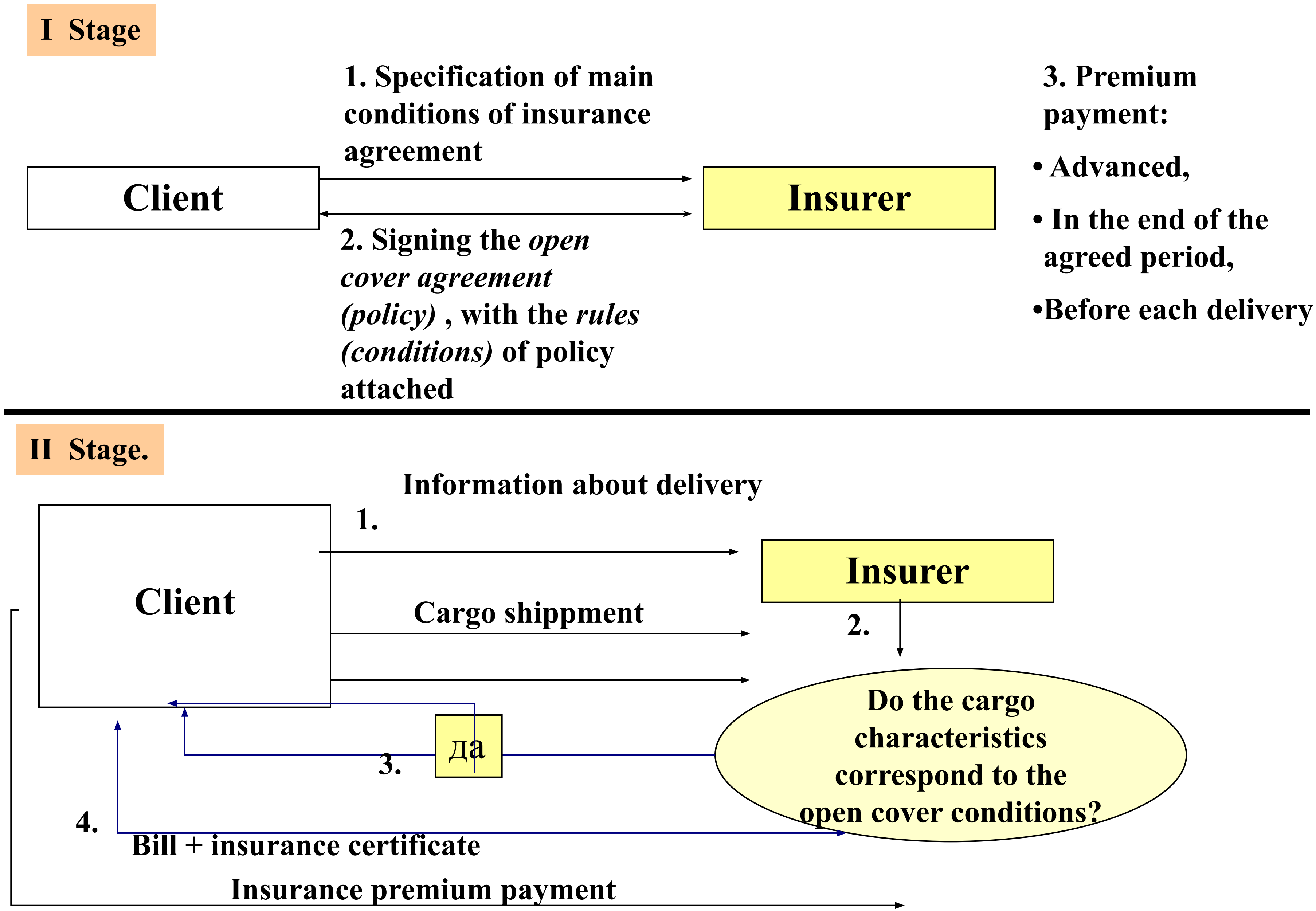
Applicable when:

- Is issued once by the insurer under contract to cover all shipments (of cargo with similar characteristics) made by the exporter over a period of time (one year usually)

Open policy conditions:

- ✔ Cargo characteristics;
- ✔ Shipments periods and transportation routes;
- ✔ Client’s loss statistics;
- ✔ Type of vehicle;
- ✔ Limits of sum insured by one vehicle;
- ✔ Forecasted trade turnover of a company during the year ;
- ✔ Insurance conditions & rates

Open cover


I Stage
1. Specification of main conditions of insurance agreement
Client
Insurer
2. Signing the *open cover agreement (policy)* , with the *rules (conditions)* of policy attached
3. Premium payment:
• Advanced,
• In the end of the agreed period,
•Before each delivery
II Stage.
Information about delivery
1.
Client
Insurer
Cargo shippment
2.
Do the cargo characteristics correspond to the open cover conditions?
да
3.
4.
Bill + insurance certificate
Insurance premium payment

Sum insured (cargo)

- **Max sum insured by open policy on annual basis**
- **Max limit by each single delivery**
- **Additional conditions can be specified**, for example:

«Партии грузов стоимостью свыше ______USD заявляются Страхователем не позднее, чем за 2 дня до начала предполагаемой отправки»

« If cost of consignment exceed ______ USD it must be declared by the Insured not later than 2 days prior to the beginning of expected dispatch »

Open cover (frequent deliveries)

Client

During the month:

Cargo shipments →

Insurer

Бордеро – подробные сведения об отдельных отправках*/ List of shipments' details

←

Акцепт (Страховой сертификат) / Issue of insurance certificate for each accepted shipment

В конце месяца страхования (обычно - не позднее пятого рабочего дня месяца, следующего за отчетным)/ in the end of month

←

- Bill (страховая сумма по всем перевезенным грузам * тариф)

- Deposit withdrawal

* - По требованию страховщика - копии документов (инвойсов, коносаментов и т.п.), подтверждающих стоимость каждой единицы товара и их количество по каждой отправке

Open cover

Advantages:

- decreasing the administrative costs

-all the shipments automatically insured for 1 year

- 20 – 30% chipper than the single policy

Disadvantages:

- cooperation only with one insurer during the whole year

Sum insured:

Forecasted invoice cost of cargo + All the transportation expenses*

*** -** ***Expenses on the freight, customs clearance fee, expenses on the armed support etc.***

What factors influence on the amount of the insurance rate and cost of insurance?

- Insurance Conditions (A, B, C - ICC)
- Type of the cargo and the probability of its damage
- Packing quality and its meet to the character of cargo
- Character of Transportation
- Type of the Vehicle
- Seasonal Factors
- Distance, expeditors accompaniment
- The number of re-loadings in transit
- Length of the period of insurance
- Size of deductible

International Cargo Clauses (ICC)

A, B, C *Clauses of ICC* - Institute Cargo Clauses (Institute of London Undewriters)

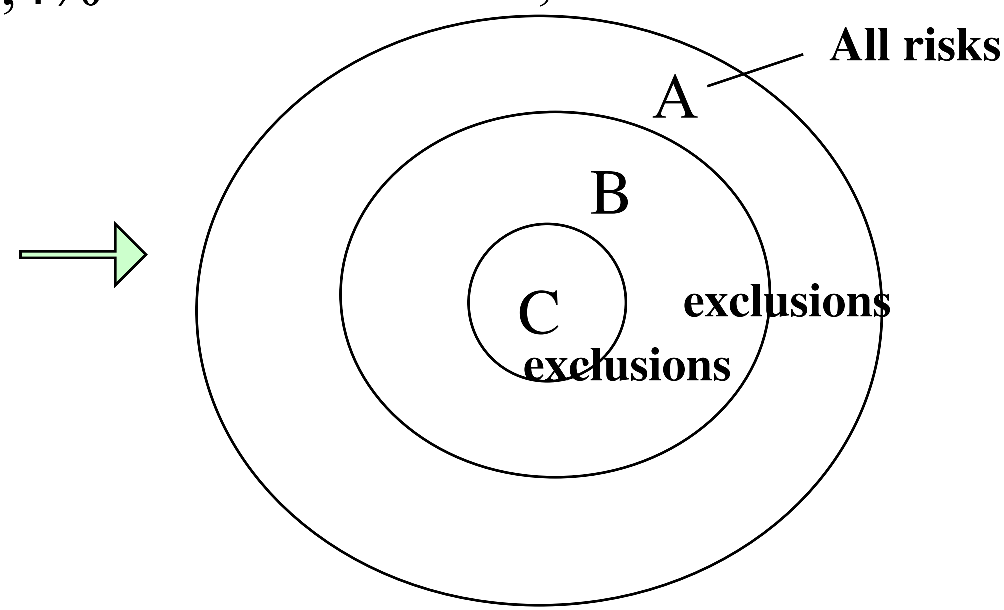
Insurance premium (in % of the Sum insured)

C = 0,2 – 0,4%

B = 0,4 – 0,6%

A = 0,6 – 0,8%

Risks and Insurance coverage



Cargo insurance conditions

Clauses cover all risks of loss of or damage (All risks)

Clauses cover the risks of loss of or damage except (list1) (With particular average)

Clauses cover the risks of loss of or damage except (list 2) (Free from particular average)

Risks of storage

Cargo insurance conditions

All risks (A)

Damage, total destruction or loss of the whole cargo or any part thereof (1)	Expenses and contributions allowed by general average (2)	All necessary and properly incurred expenses for salvage of the cargo (3)

With particular average (B)

Damage, total destruction or loss of the whole cargo or any part thereof as a result of the listed risks + (2) + (3)

Free from particular average (C)

Total destruction or loss of the whole cargo, or any part thereofas a result of the listed risks + (2) + (3)

Comparative analysis of ICC coverages

Loss Caused By or Resulting From:	*Free of Particular Average*	*With Average*	*All Risks*
Stranding	YES	YES	YES
Sinking	YES	YES	YES
Burning	YES	YES	YES
Collision	YES	YES	YES
Faults or errors in the management of the vessel	YES	YES	YES
Bursting of boilers	YES	YES	YES
Latent defects in hull or machinery	YES	YES	YES
Explosion	YES	YES	YES
Jettison	YES	YES	YES
Heavy weather*	NO*	YES	YES
Seawater as a result of heavy weather*	NO*	YES	YES
Freshwater	NO	NO	YES
Improper stowage by the carrier	NO	NO	YES
Hook damage, mud and grease	NO	NO	YES
Theft of an entire shipping package	NO	NO	YES
Non-Delivery of an entire shipping package	NO	NO	YES
Pilferage	NO	NO	YES

* *Refers to partial losses. Total loss of cargo from these perils would be covered.*

Carrier’s liability insurance

Insurance of liability for international transportation organizations

- **Responsibility to cargo damage (**including insurance within the limits of convention КДПГ 1956). **Risks:** destruction, loss of cargo in case of road accident, a fire, overturning of a vehicle, theft
- **Responsibility for the financial losses connected with consequences of omissions of transport company's employees. Risks:** ***delay in delivery***, wrong send of cargo, failure to carry out of instructions of the sender, wrong official registration of papers etc.
- **Responsibility to the third parties. Risks:** a damage caused by cargo to property, life and/or health of individuals or business, surrounding environment
- **Warranty insurance TIR** (a financial guarantee for customs in auto transportations). **Risks:** Responsibility for payment of customs fees to premises of the goods under a customs regime (the Insurance sum amounted USD 50 000 under one TIR carnet).
- **Responsibility to customs in the international transportation of cargoes** with application of TIR carnets or other customs' papers.

Claim cover limitations (cargo damage)

Type of transportation	Reimbursement for 1 kg of damaged or lost cargo	Declared interest option	International Conventions regulated
Auto transportation	8,33 SDR*	+	**The convention on the agreement of the international road transportation of cargoes (КДПГ 1978)**
Railway transportation	17 SDR	+	**The convention on the international rail transportation (КОТИФ 1980)**
Sea transportation	2 – 2, 5 SDR	-	**The Hamburg rules (1978)** **Amendments to the Hague Rules / to the Visbijsky report**
Aviation transportation	17 SDR	+	**Montreal protocols (1975)**

* - The SDR is an international reserve asset, created by the IMF in 1969

Special Drawing Rights (SDR) Valuation

Friday, September 10, 2010				
Currency	Currency amount under Rule O-1	Exchange rate [1]	U.S. dollar equivalent	Percent change in exchange rate against U.S. dollar from previous calculation
Euro	0.4100	1.27290	0.521889	0.02
Japanese yen	18.4000	83.99000	0.219074	-0.38
Pound sterling	0.0903	1.54560	0.139568	0.27
U.S. dollar	0.6320	1.00000	0.632000	
			1.512531	
		U.S.$1.00 = SDR	**0.661143** [2]	**0.021**
		SDR1 = US$	**1.51253** [4]	

It is calculated as the sum of specific amounts of the four currencies valued in U.S. dollars, on the basis of exchange rates quoted at noon each day in the London market.

Specific of handling claims

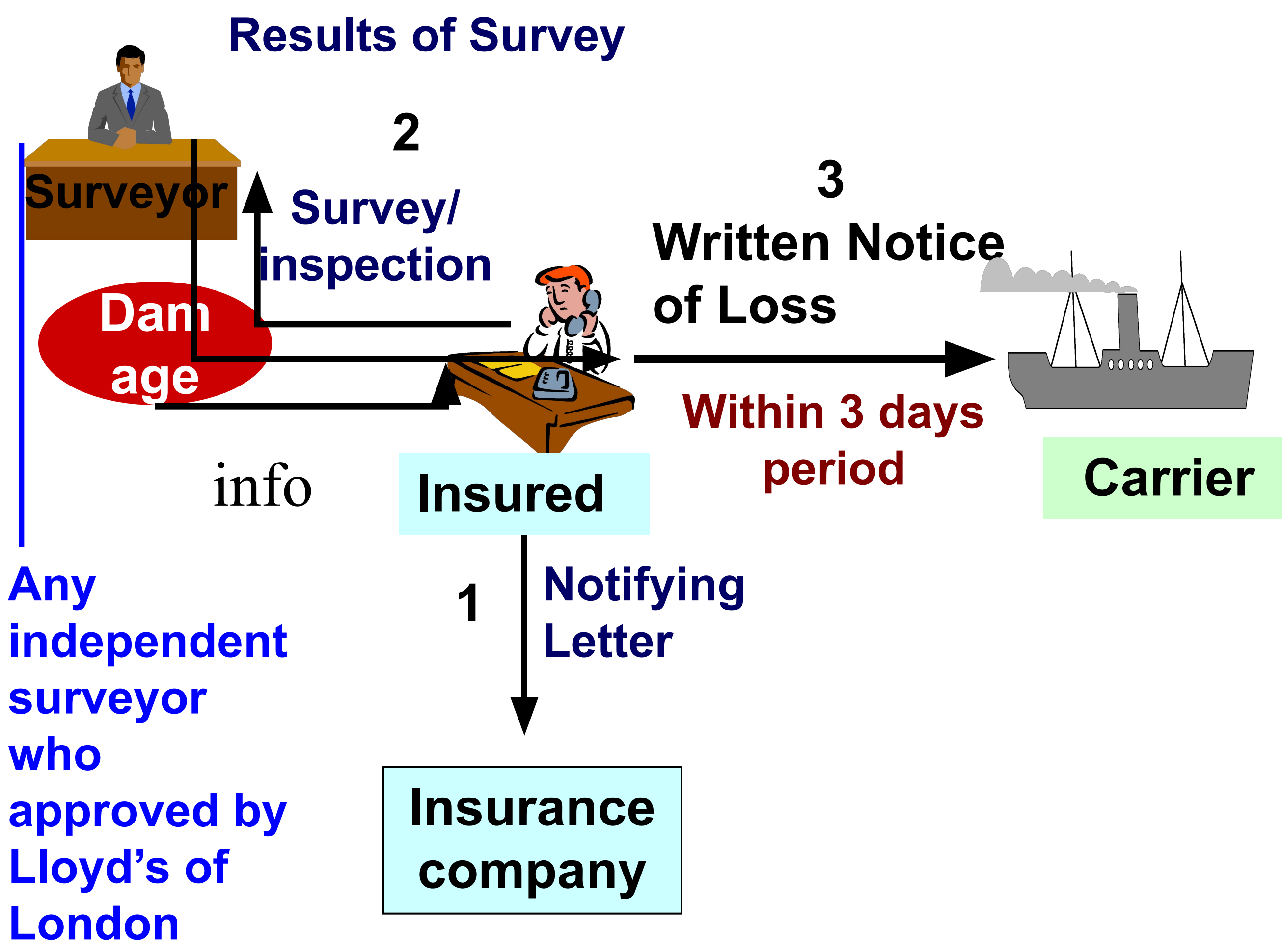
Handling of claims

What are the steps if the losses took place ?

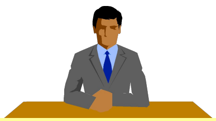
Confirm the fact, place and reasons of the losses to prove the fact of the <u>**insurable event**</u>
Confirm the cost and ownership of the property to prove the fact of the <u>**insurable interest**</u>
To define and to prove the <u>**amount of loss**</u>

The process of handling the claims

First Tree Steps:



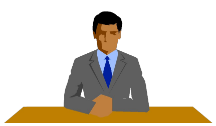
Who else involved in claim producing process?



Surveyor

Defines:

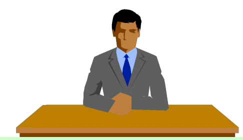
- Fact of damage
- Amount of loss
- Fact of insured event



Adjuster

Adjusters and examiners:

- Investigate insurance claims
- Negotiate settlements
- Authorize payments



Insurance Broker

Consultancy

Preparing necessary documentation

Work with insurer

What documents are included in the claim to insurance company?

- ✔ Proof of ownership of cargo
- ✔ Survey report (with color photos)
- ✔ Cargo invoice (showing value of cargo)
- ✔ Statement of claim (claimed amount and cause of damage)
- ✔ Disposal/ destruction certificate or proof of salvage value

Survey report is one of the most important documents for insurer

A survey should contain the following information:

- Date/place of survey
- Date of delivery of cargo into the custody of the consignee (you)
- Vessel’s name and voyage number
- Bill of Lading (or Invoice) number
- Container number(s)
- Cargo description
- Background for survey held
- Accurate description of the survey process (cargo condition, container(s), etc.)
- Extent of damage
- Probable cause of damage
- Colour photos
- Conclusion

Generally the following documents will be required to settle a claim

1. Proof of Insurance: Declaration Form or Original Certificate
2. Commercial Invoices
3. Non-negotiable copy of bill of lading or air waybill (front and back)
4. Claim Statement (an itemization of loss/damage claimed).
5. Copy of letter(s) to carrier(s) giving notice of claim.
6. Carrier's reply(s) if any.
7. Delivery receipts with exceptions noted.
8. Photographs
9. Survey report
10. Packing List.
11. Repair estimates (when applicable)

Additional documents may be requested at a later date !

Cases when insurers don’t respond to the clients

When claims have to be sent to the sellers or carriers directly:

- ✔ Cargo have been lost or damaged because of the delay in delivery
- ✔ If there is no damage to the packages or seals on the containers are not broken
- ✔ Lost or damage of cargo resulted from the improper packaging
- ✔ Re-grading of goods

3. Insurance of international credits and investments

Country risks classification

Political risks are related either to the country of a foreign buyer or borrower, or to a third country which can cause the exporter, investor or financier to incur a credit loss.

Political risks include:

-restrictions on transfer of the credit currency,

-rescheduling of debts,

-expropriation, and war or insurrection.

Commercial risks Commercial risks arise from foreign banks, companies or project companies.

Typical **commercial risks** include

- the buyer's, borrower's or guarantor's insolvency
- unwillingness to pay its debt.

Political risks

Political risk may materialise as the ***consequence of a long course of events***, or may ***result from internal or external economic and political shocks***.

Political risks are assessed according to the following criteria:

1. ***Economic growth potential***
2. ***Economic policy***
3. ***Vulnerability***
   - size of the economy
   - dependence on exports/imports
   - dependence on foreign aid
4. ***Indebtedness and finance***
   - balance of payments
   - foreign debt
   - access to finance
5. ***Foreign and domestic policy***
   - political structure and continuity
   - efficiency of administration
   - international relations

Political risks classification

Unforeseen events	***Political decisions***
Revolutions Power change Change of the government War risks Damage caused to employees of the company abroad	1. Pure political Goods confiscation; trading embargoes; a wrongful response of a guarantee changes in legislation; refusal of the declared intentions; contract cancellation by the private counterparty 2. Risks of administrative character Licence withdrawal; an obstacle to carrying out of export or import operations 3. Risks of macrolevel An interdiction for converting operations; cardinal changes in economic policy 4. Risks of microlevel Unilateral cancellation of the contract by the counterparty (the state company); non-payment of the state buyer; default of judicial arbitral awards; non-delivery of production because of political views

Risk management for political risks

Internal techniques:

-Decreasing overall risk exposure (choice of country or trade portfolio structure)

-Increasing of operational earnings (contract price regulation)

External techniques :

-Letter of Credit (Revocable and Irrevocable)

-Factoring

-Insurance

Commercial risks

- Financial risk assumed by a seller when extending credit without any collateral or recourse.

- The risk that a debtor will be unable to pay its debts because of some business events

Guarantees offered to exporter in the export/import operations

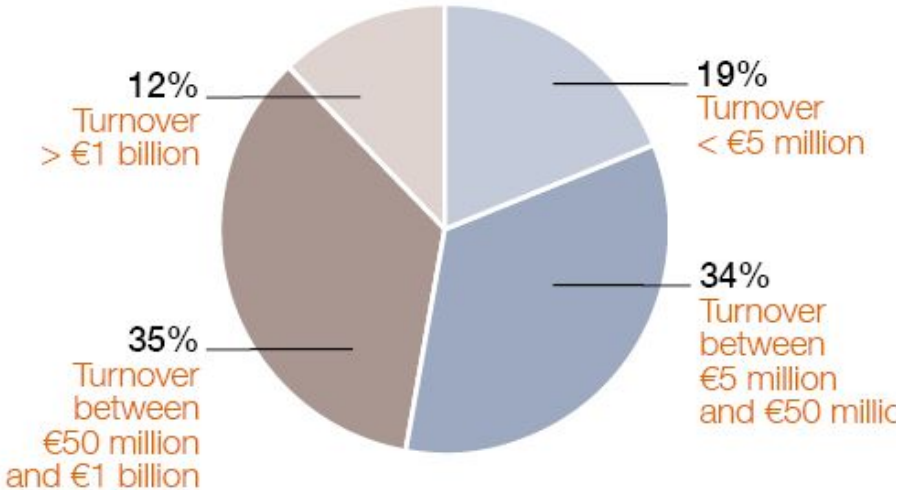
- **Credit Risk Guarantee** provides the exporter with cover against credit losses in export trade.
- **Buyer Credit Guarantee** provides lenders with security against credit risks caused by a foreign buyer, buyer's bank or buyer's country. An LCF Guarantee is based on terms and conditions of the Buyer Credit Guarantee supplemented with additional terms.
- **Letter of Credit Guarantee** is an insurance for domestic or foreign confirming bank.
- **Bank Risk Guarantee** - For securing conter-guarantees associated with export trade.
- **Investment Guarantee** can be used by domestic investors to cover foreign investments against political risks.
- **Bond Guarantee** is an insurance for the exporter and/or counter-security for the bond issuer.
- **Finance Guarantee** provides a lender with security for credits received by exporters to finance exports.

Biggest credit insurers/guarantee providers in Europe

Company/ owner	*Country of origin/ Market for services*
NCM - Private	Netherlands /UK
Export Credit Guarantee Department (ECGD) – State	UK/UK
Euler Hermes - Private	Germany/EU
Atradius - Private	Nitherlands/EU
Coface - State/Private	France/EU
OND - State	Belgium/ Belgium
SACE - State	Italy/Italy
Österreichische Kontrollbank AG (OeKB) - State	Austria
NEXI (Nippon Export and Investment Insurance) –State/Private	Japan/Japan

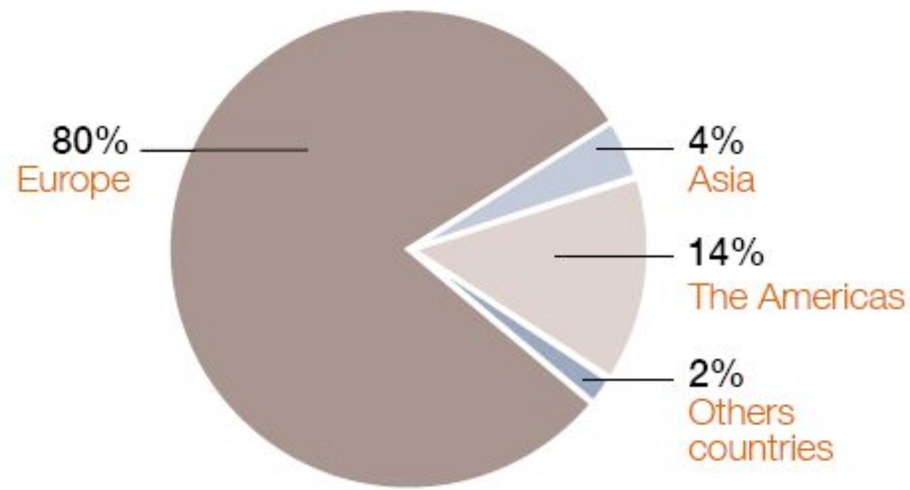
Coface

Coface's portfolio segmentation by size of companies

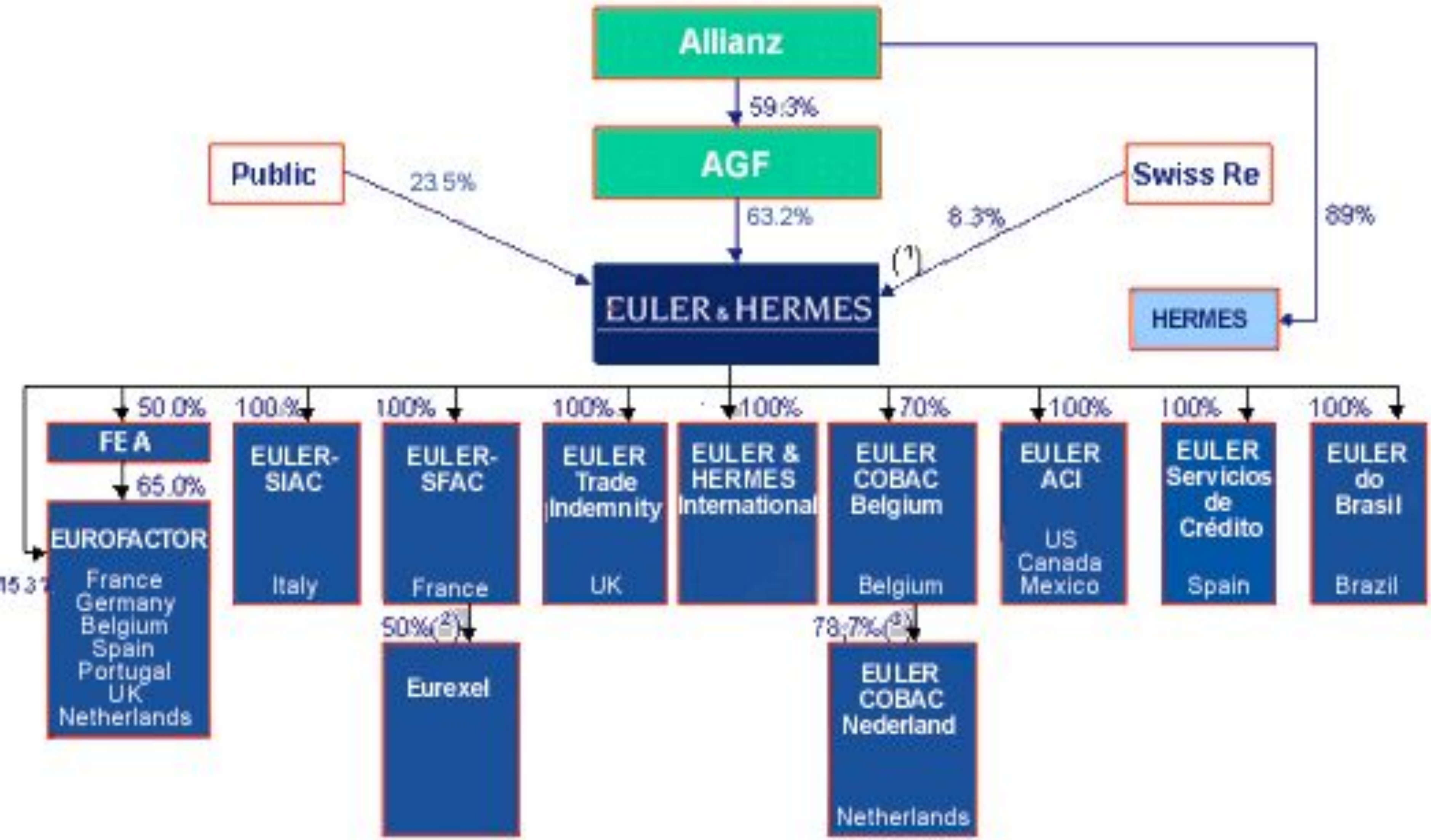


Distribution of Coface's clients by geographical zone*

* Numbers of clients for all business lines.



Euler Hermes Group



Guarantee Services

Guarantees are issued for clients in respect of their contractual or statutory obligations to their principals at home and abroad, comparable to bank guarantees.

Insurer guarantees a payment of principal and interest in connection with debt instrument issued by purchaser.

Guarantee Premiums

Short-term (repayment period less than 2 years) Buyer Credit and Credit Risk Guarantees usually cover **corporate risk**;

in consequence, the *total premium* charged includes both the <u>political base</u> rate and a <u>commercial surcharge</u>.

The **short-term corporate risk** is divided into **4 "premium categories".**

For country categories 0 and 1 premium category I,

for country categories 2 and 3 premium category II,

for country categories 4 and 5 premium category III

and for country categories 6 and 7 premium category IV.

Example of Guarantee Premiums Table

CREDIT RISK GUARANTEES/
CORPORATE RISK PREMIA (%)

RISK	commercial	**political + commercial**	**political + commercial**	**political + commercial**	**political + commercial**
Premium Category		I	II	III	IV
Country category		0 and 1	2 and 3	4 and 5	6 and 7
3 months	0.35	0.45	0.52	0.68	0.90
6 months	0.40	0.52	0.61	0.81	1.08
9 months	0.45	0.64	0.77	1.10	1.52
1 year	0.50	0.76	0.93	1.38	1.96
1 year 3 months	0.55	0.88	1.09	1.67	2.46
1 year 6 months	0.65	1.04	1.31	2.00	3.00
1 year 9 months	0.75	1.21	1.52	2.34	3.54

Country Ratings

Rating classification for credit guarantees' rates:

0 : Advanced economy - no minimum premium rate

1 : Very low risks

2 : Low risks

3 : **Relatively low risks**

4 : Intermediate risks

5 : Relatively high risks

6 : High risks

7 : Very high risks

Country classification is determined by:

- ❖ an assessment of the country's ability to meet its external liabilities
- ❖ expectations of the country's economic development
- ❖ political stability
- ❖ the legislative environment

Country classification influences on:

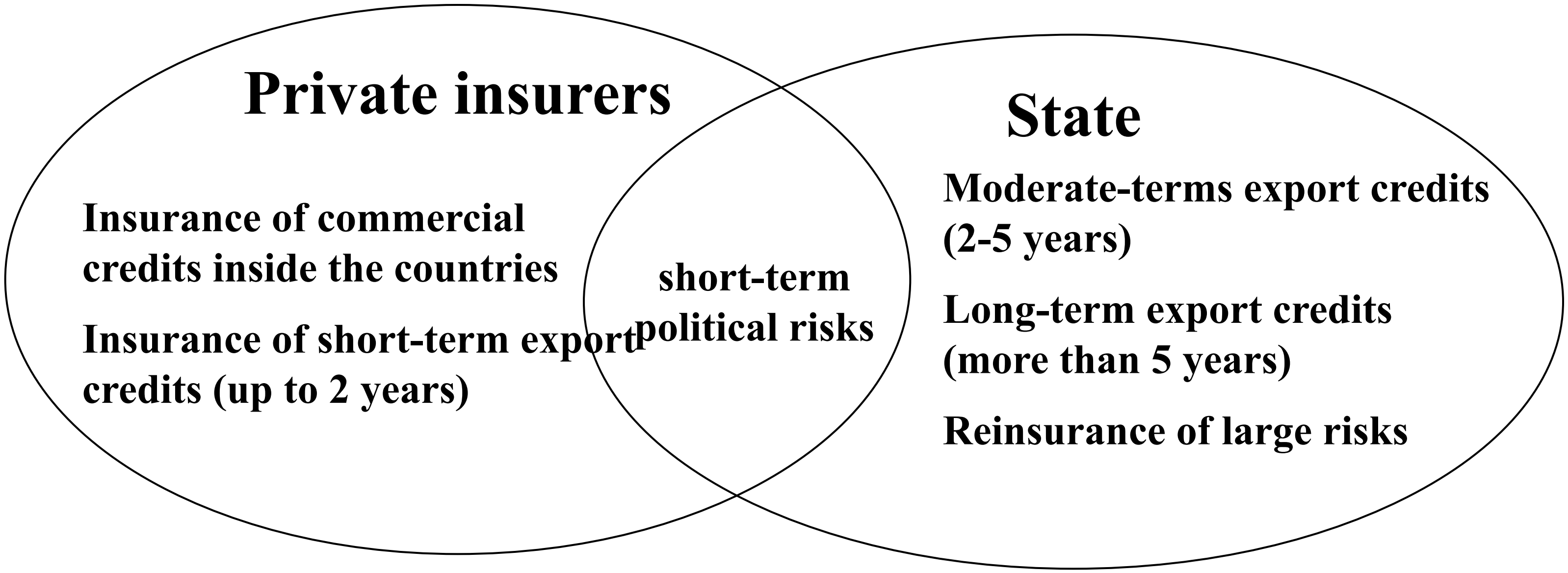
- ❑ the level of the guarantee premium
- ❑ the security requirements

Credit rating agencies

- **Business Environmental Risk Intelligence (BERI)**
- **Frost and Sullivan (Index WPRF – World Political Risk Forecasts)**
- **Standard & Poor's Rating Group**
- **Moody's Investor Services**
- **Political Risk Services: International Country Risk Guide**
- **Coface**

Credit Insurance

Structure of credit insurance market



Credit insurance helps company to manage the credit it extends to its customers and protects the against the risks of a customer default.

It allows to improve trade receivables management and support revenue growth

Capital concentration in the European credit insurance market

	Share of market in 2005
Leading insurers: -Euler Hermes -Atradius -Coface	**87%**
Others	**13%**

Commercial insurance companies, operating on the export credit insurance market

Lloyds of London (Robert and Hiscox syndicate) - UK

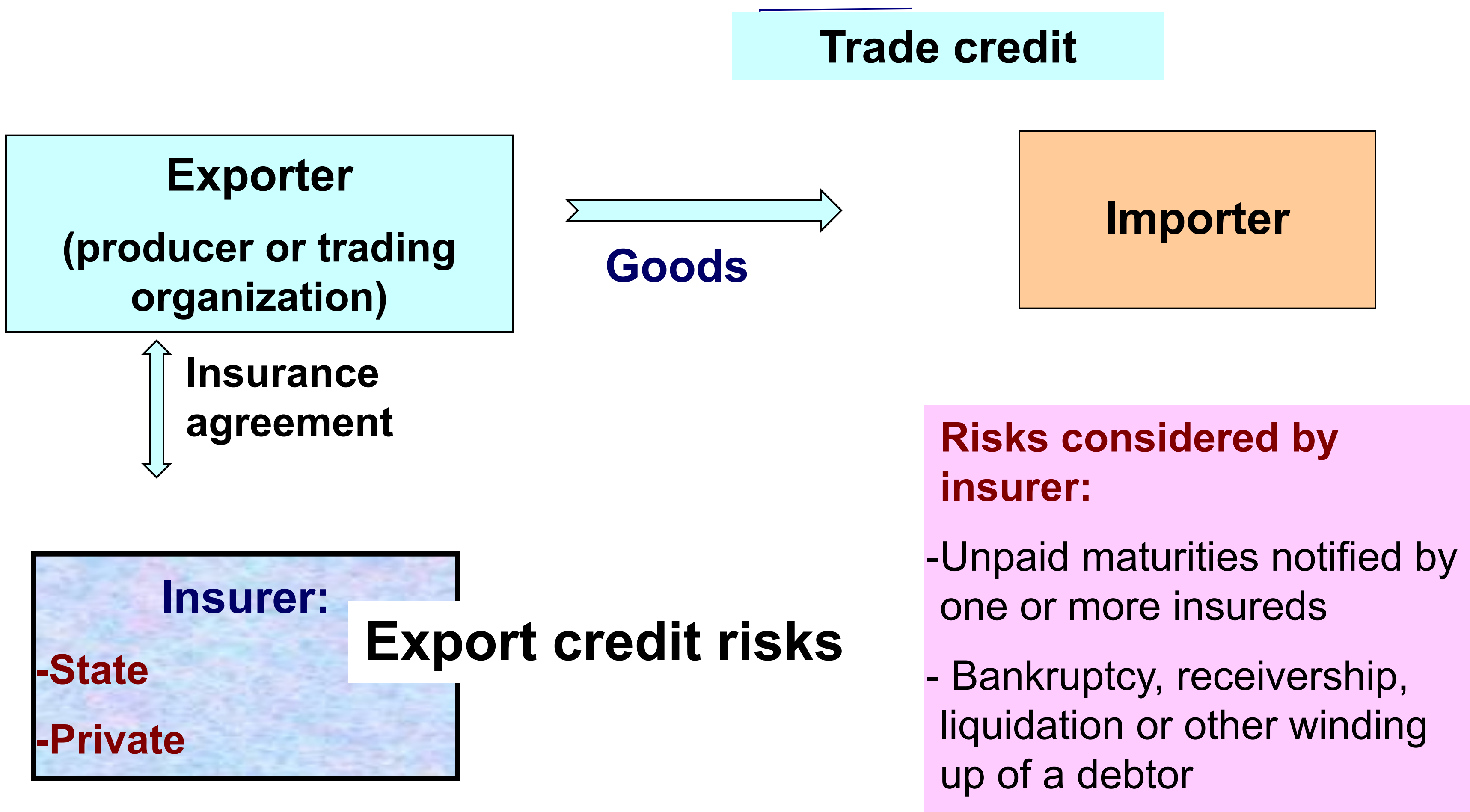
American international group (AIG) - USA

Unistrat Assurances – France

Gerling Kreditversicherungs AG – Germany

Ingosstrakh - Russia

Export credit scheme



Types of credit insurance policies

1. Extraordinary coverage (specific coverage)

Is used when the outstanding balances of a single customer or a few customers represent a serious exposure to a firm

Generally purchased by companies who deal with limited number of customers

2. General coverage policy

Includes protection on all policyholder's customers with a credit rating as specified in a policy

Each account insured must have a capital and credit rating, which express the net worth of the company and its credit standing

The coverage on each account is determined by a table of ratings, selected by the insured and included in contract

Sales to customers outside of these classifications is at the insured's own risk.

Stages of insurance

1 **Stage**: Application to insurance

Client (exporter) — Insurer

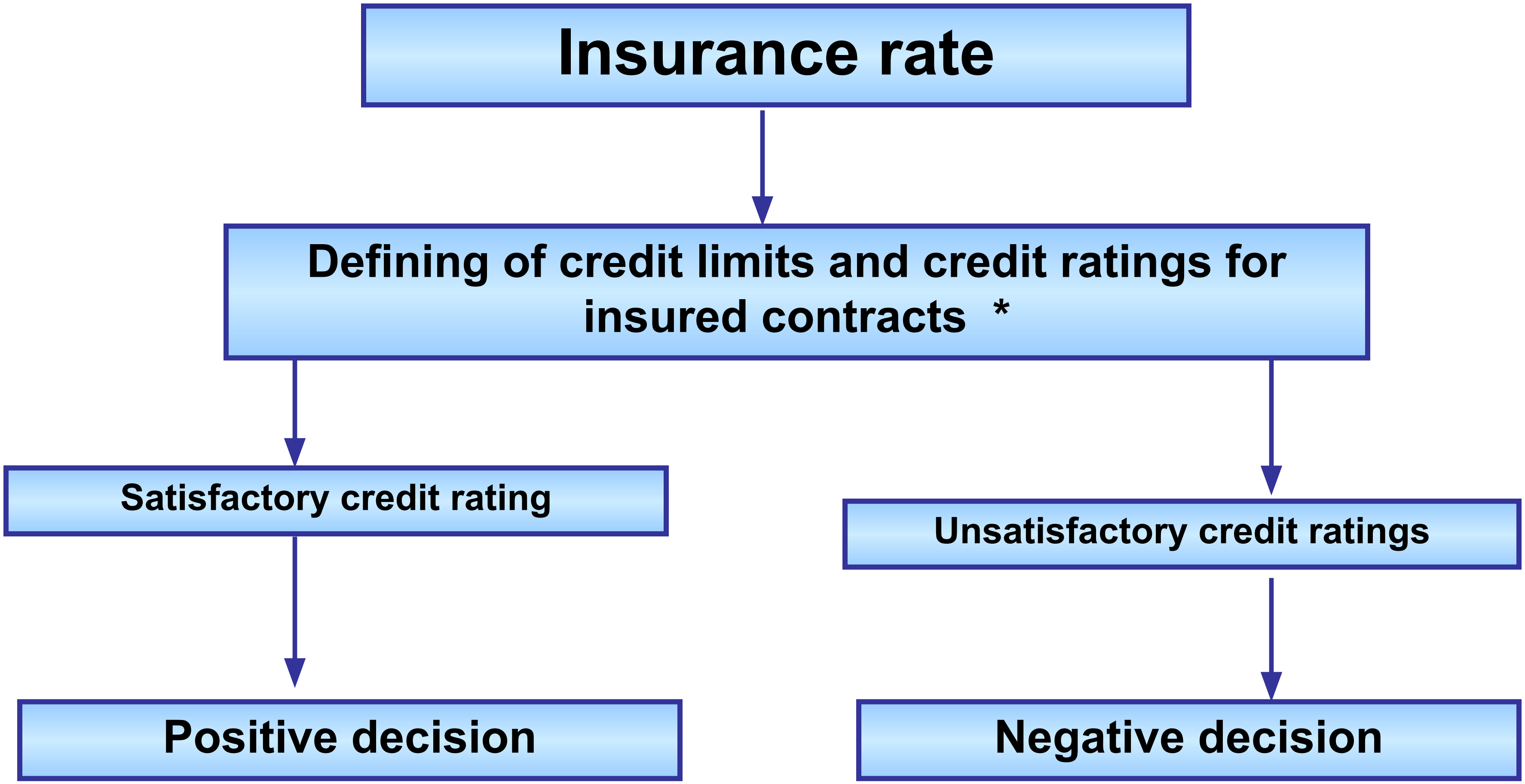
2 **Stage**: Rate making

Insurer — Risk analysis — Decision about taking for insurance the risk

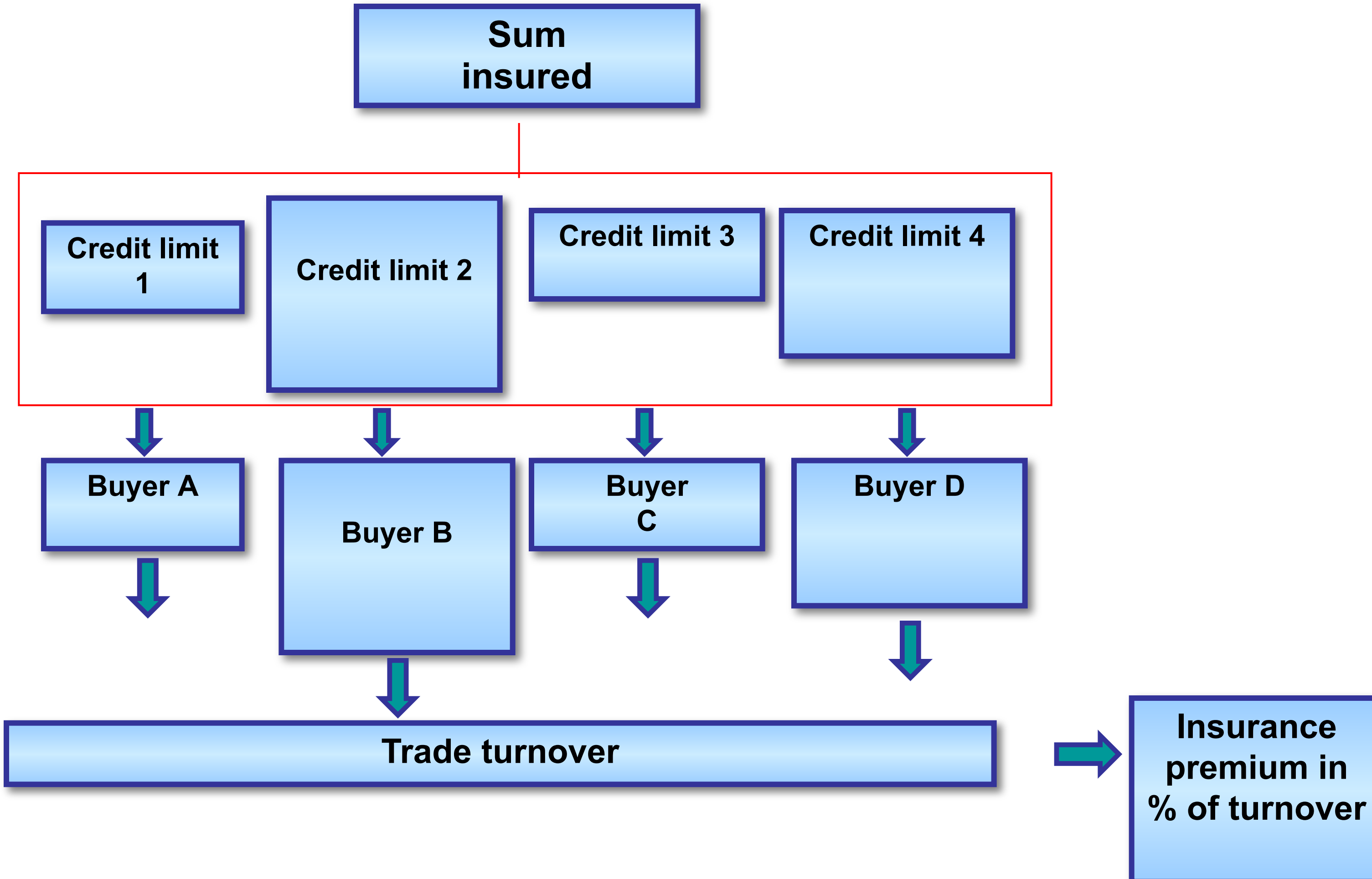
Declining application

Accepting application

Factors, influencing on the decision about insurance



Setting up the sums insured



Corrections of the sums insured

Buyer

Monitoring of contractors enables to make one of the following decisions:

1. Improving of financial results

Increasing the credit limits

2. Credit rating hasn’t changed

Credit limits are left unchanged

3. Financial results became worse

Revision of insurance conditions

4. Serious declining of financial position

Revision of insurance conditions

Risk analysis of credit portfolio and conditions of insurance

Buyer

Risk class (solvency, financial stability, ratio analysis, market experience)

Deductable (usually not less than 20%)

Trade turnover

Insurance rate

Insurance coverage calculation

Loss calculation scheme:

Amount of debt

minus

Sum that was partially paid

Revenue from the sales of returned goods

=

Debt of buyer

minus

Deductable

=

Insurance coverage

Example of coverage table (credit limits)

Credit Rating	Sum insured	If Credit Loss	Coverage
AAA	$ 50 000	$ 70 000	$ 50 000
AA1	$ 40 000		
BBB	$ 30 000		
BB1	$ 20 000		

Coinsurance and Loss

Credit Rating of account	Amount of debt	Admitted Loss	Coverage Less Coinsurance (10%)
AAA	$ 70 000	$ 50 000	$ 45 000
AA1	$ 50 000	$ 40 000	$ 36 000
			$ 81 000
Normal loss deductible			- 10 000
Recovery from credit insurer			$ 71 000

Пример расчета Страхового возмещения

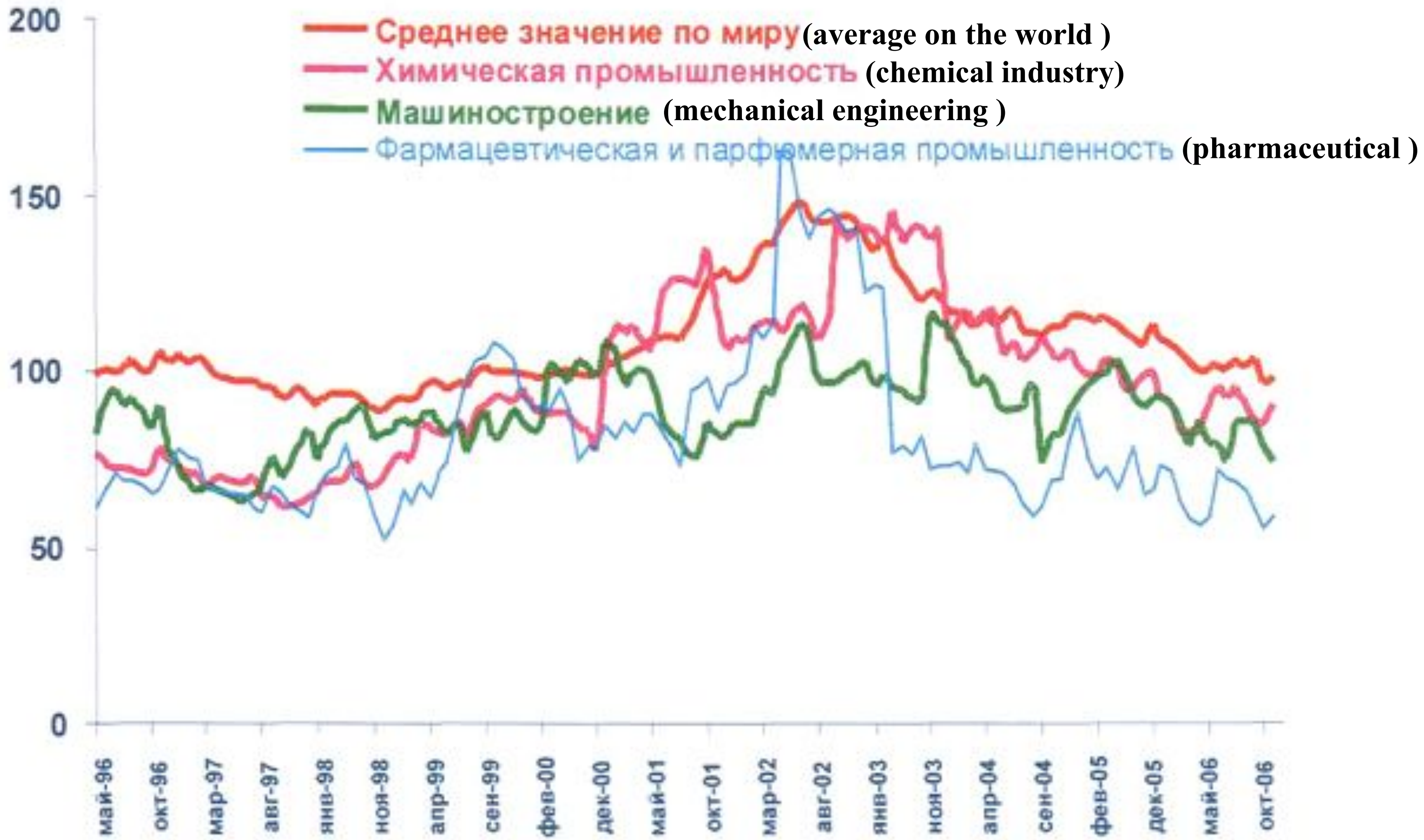
Условия:

Поставлен товар на сумму 100 000.00 руб.
Безусловная франшиза-20%
Сумма неоплаченного счета- 50 000.00 руб.
Сумма, полученная Страхователем при помощи Страховщика в течение Периода ожидания- 25 000.00 руб.

Расчет:

Фактическая задолженность: 50000-25000=25000 руб.
Сумма страхового возмещения: 25000-20%=20000 руб.

Dynamics of payments' delays index by branches of economics (Basis - 100)



Source: Sector Analysis, Documentation by Dominique Fruchter - Paris: Coface University, 2007 - c 24

Dynamics of payments' delays index by branches of economics (Basis - 100)

Source: Sector Analysis, Documentation by Dominique Fruchter - Paris: Coface University, 2007 - c 24

Branch risks by regions and the world countries (according to ratings of *Coface*)

Min risk

Минимальный риск

Max risk

Высокий риск ^

	A+	A	A-	B+	B	B-	C+	C	C-
Авиатранспорт					Западная Европа	Япония Восточная Европа	Северная Америка		
Автомобильная промышленность		Япония		Восточная Европа Азия Латинская Америка		Западная Европа		Северная Америка	
Химическая промышленность		Япония Азия	Западная Европа Северная Америка	Восточная Европа Латинская Америка					
Производство одежды			**Азия**		Восточная Европа	Латинская Америка		Северная Америка	Западная Европа Япония
Строительство			Восточная Европа Азия	Западная Европа	Северная Америка Латинская Америка	Япония			
Электроника		Северная Америка **Азия**		Япония	Западная Европа				
Информационные технологии				Восточная Европа Азия Латинская Америка		Западная Европа Северная Америка Япония			

Source: Sector Analysis, Documentation by Dominique Fruchter - Paris: Coface University, 2007 - c 34

International investments' insurance agencies

Multilateral Investments Guaranteeing Agency (MIGA) - a member of the World Bank Group

<u>MIGA Member Countries</u> (168):

- ***Industrialized Countries (23)*** **- Australia, Austria, Belgium, Canada, Denmark, Finland, France, Germany, Greece, Iceland, Ireland, Italy, Japan, Luxembourg, Netherlands, Norway, Portugal, Slovenia, Spain, Sweden, Switzerland, United Kingdom, United States**
- ***Developing Countries (145)***

Source: http://www.miga.org

Functions of MIGA

MIGA is a multilateral risk mitigator, promoting foreign direct investment into developing countries by:

INSURING investors against political or noncommercial risks

Political risks insured:

- ✔ **Currency transfer restriction**
- ✔ **Expropriation**
- ✔ **War and civil disturbance**
- ✔ **Breach of contract**

Who eligible for MIGA's Guarantee Coverage?

- New cross-border investments originating in any MIGA member country, destined for any developing member country
- New investment contributions associated with the expansion, modernization, or financial restructuring of existing projects

Investment projects must be financially and economically viable, environmentally sound, and consistent with the labor standards and other development objectives of the country hosting the investment

MIGA's Reinsurance Partners (1)

Investment Insurer	Country
ACE Global Markets, Lloyd's Syndicate 2488	UK
Alleghany Consortium, Lloyd's Syndicate 376	UK
C.N.R. Atkin Esq., and Others, Lloyd's Syndicate 1183	UK
Compagnie Française d'Assurance pour le Commerce Extérieur (COFACE)	France
Cox Insurance Holdings PLC., Lloyd's Syndicate 2591	UK
Export Credits Guarantee Department (ECGD)	UK
Export Development Corporation (EDC)	Canada
Finnvera Plc	Finland
Garanti-Institutte for Eksportkreditt (GIEK)	Norway
Global Re, BV, captive insurer of Philips Electronics N.V.	Netherlands
Great Northern Insurance Company (Chubb & Sons)	USA
Israel Foreign Trade Risks Insurance Corporation (IFTRIC)	Israel
Münchener Rückversicherungs-Gesellschaft	Germany
National Union Fire Insurance Co. of Pittsburgh (AIG)	USA
Nederlandse Financierings-Maatschappij voor Ontwikkelingslanden N.V. (FMO)	Netherlands
Oesterreichische Kontrollbank A.G. (OeKB)	Austria

MIGA's Reinsurance Partners (2)

Investment Insurer	Country
Sovereign Risk Insurance Ltd.	Bermuda
Steadfast Insurance Company (Zurich)	USA
The Goshawk War and Political Risks Consortium, Lloyd's Syndicate 9132	UK
XL London Market Ltd., Lloyd's Syndicate 1209	UK
Export Finance and Insurance Corporation (EFIC)	Australia
Servizi Assicurativi del Commercio Estero (SACE)	Italy

Currency transfer restriction

Coverage protects against:

- losses arising from an investor's inability to convert local currency (capital, interest, principal, profits, royalties, or other monetary benefits) into foreign exchange for transfer outside the host country.
- insures against excessive delays in acquiring foreign exchange caused by the host government's actions or failure to act. Currency devaluation is not covered.

Expropriation

Coverage offers protection against:

- loss of the insured investment as a result of acts by the host government that may reduce or eliminate ownership of, control over, or rights to the insured investment.
- also covers partial losses, as well as "creeping expropriation," a series of acts that over time have an expropriatory effect. Bona fide, non-discriminatory measures taken by the host government in the exercise of its legitimate regulatory authority are not considered expropriatory.

Breach of contract

Coverage protects against:

Losses arising from the host government's breach or repudiation of a contractual agreement with the investor.

In the event of such an alleged breach or repudiation, the investor must be able to invoke a dispute resolution mechanism (e.g., arbitration) set out in the underlying contract and obtain an award for damages.

The investor may file for a claim if, after a specified period of time, payment is not received.

War and civil disturbance

Coverage protects against:

- Loss due to the destruction, disappearance, or physical damage to tangible assets caused by politically motivated acts of war or civil disturbance, including revolution, insurrection, and coups d'état.
- Terrorism and sabotage are also covered.
- War and civil disturbance coverage also extends to events that result in the total inability of the project enterprise to conduct operations essential to its overall financial viability.