

# 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

Страхование. Учебник. Под ред. Федоровой Т. М.: Экономистъ, 2008

Селиверстов М.Н. Страхования экспертиза грузов. М.: Анкил, 2007

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.

Гурков И.М. Страхование грузов, ответственности перевозчиков и экспедитора Вып.4.,, М.: Выбор, 2005

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](http://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](http://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

<b>Economic risks</b>	Risk of concession in economic control Risk of insolvency of the buyer Risk of non-acceptance
<b>Financial</b>	Risk of default i.e. the failure of the buyer to pay off the due amount after <i>n-months</i> of the due date Risk of Exchange rate
<b>Commercial risk</b>	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
<b>Political risks</b>	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
<b>Buyer Country risks</b>	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

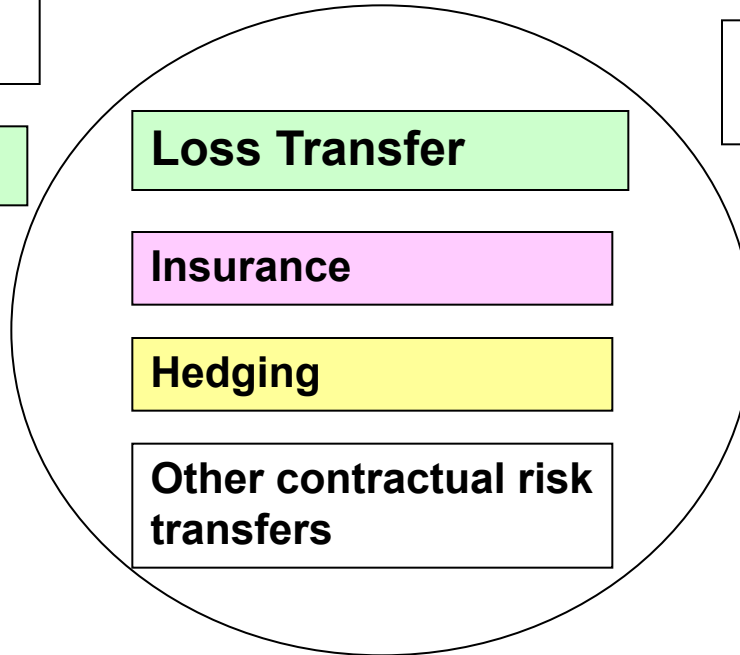
Hedging

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**

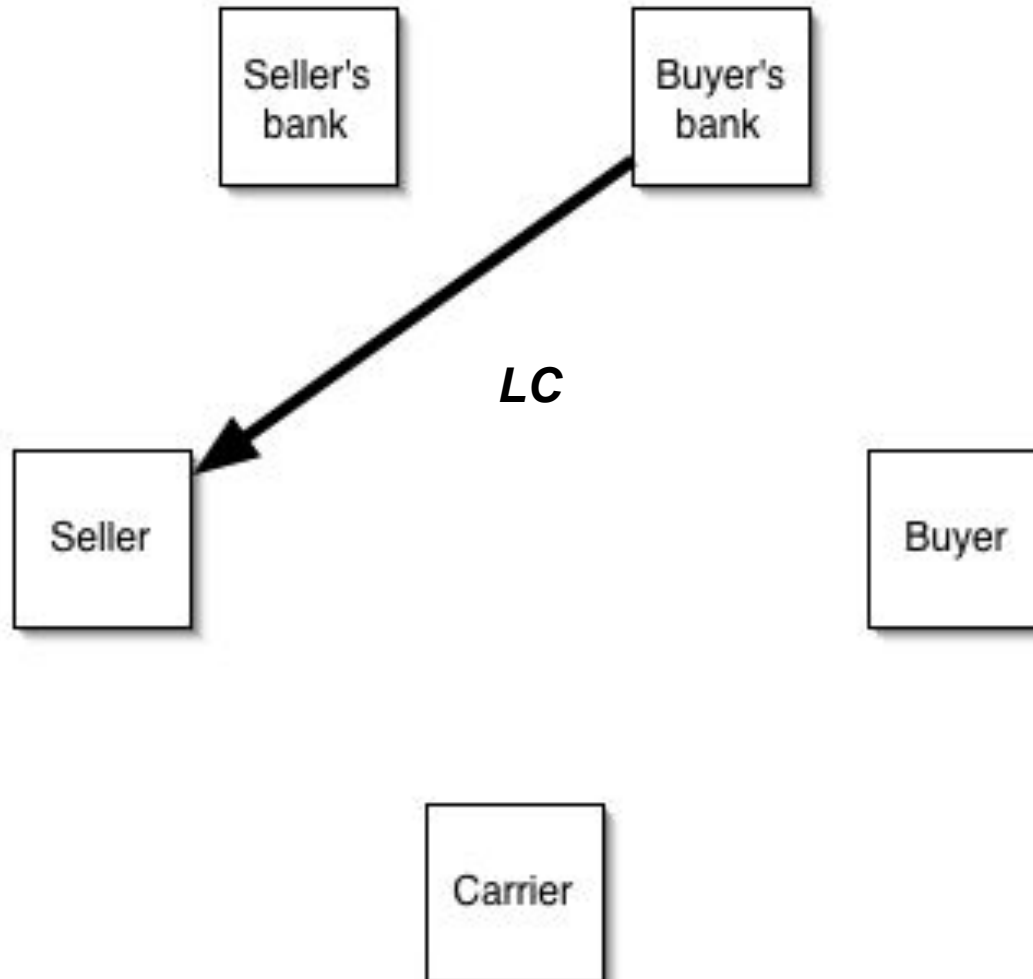
*cover against the exchange rate exposure*



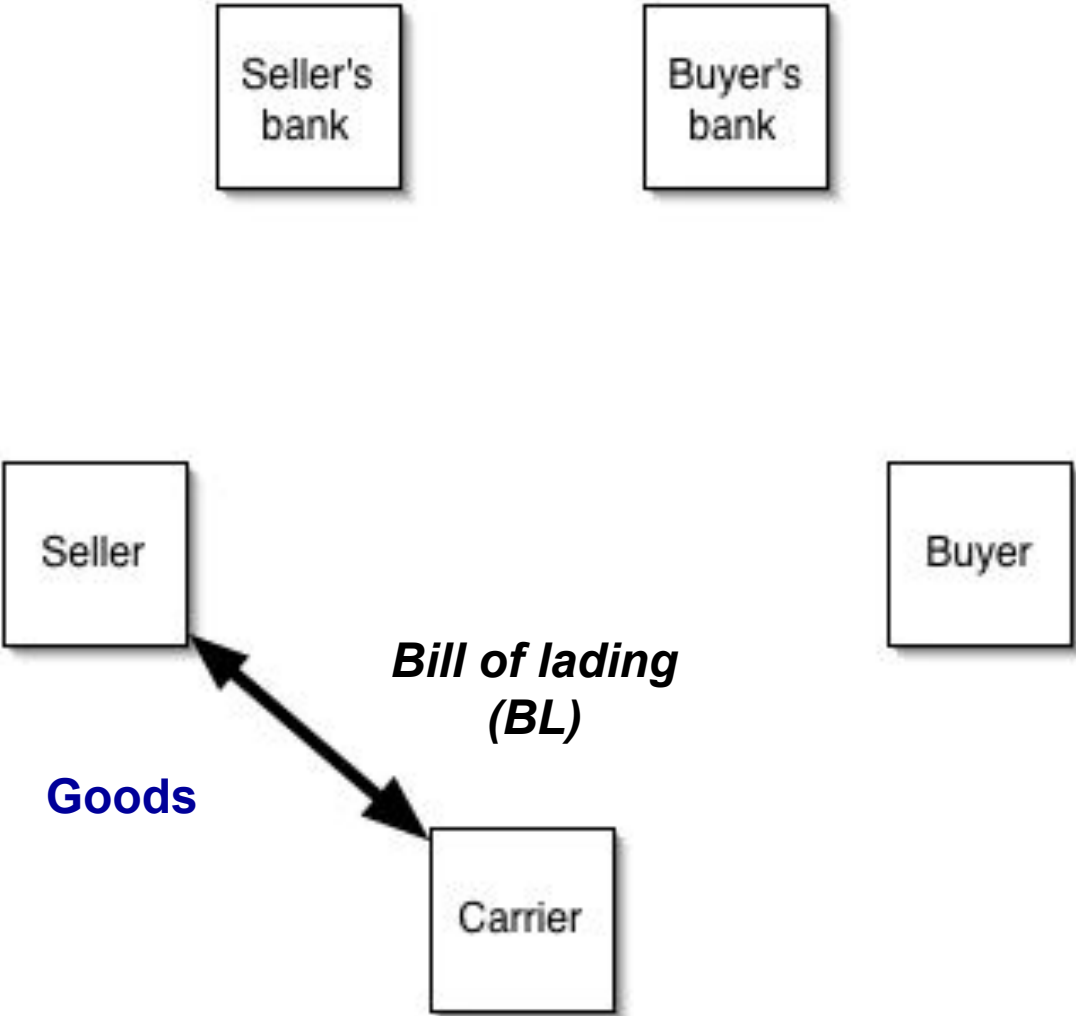
# How a documentary letter of credit works?

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.

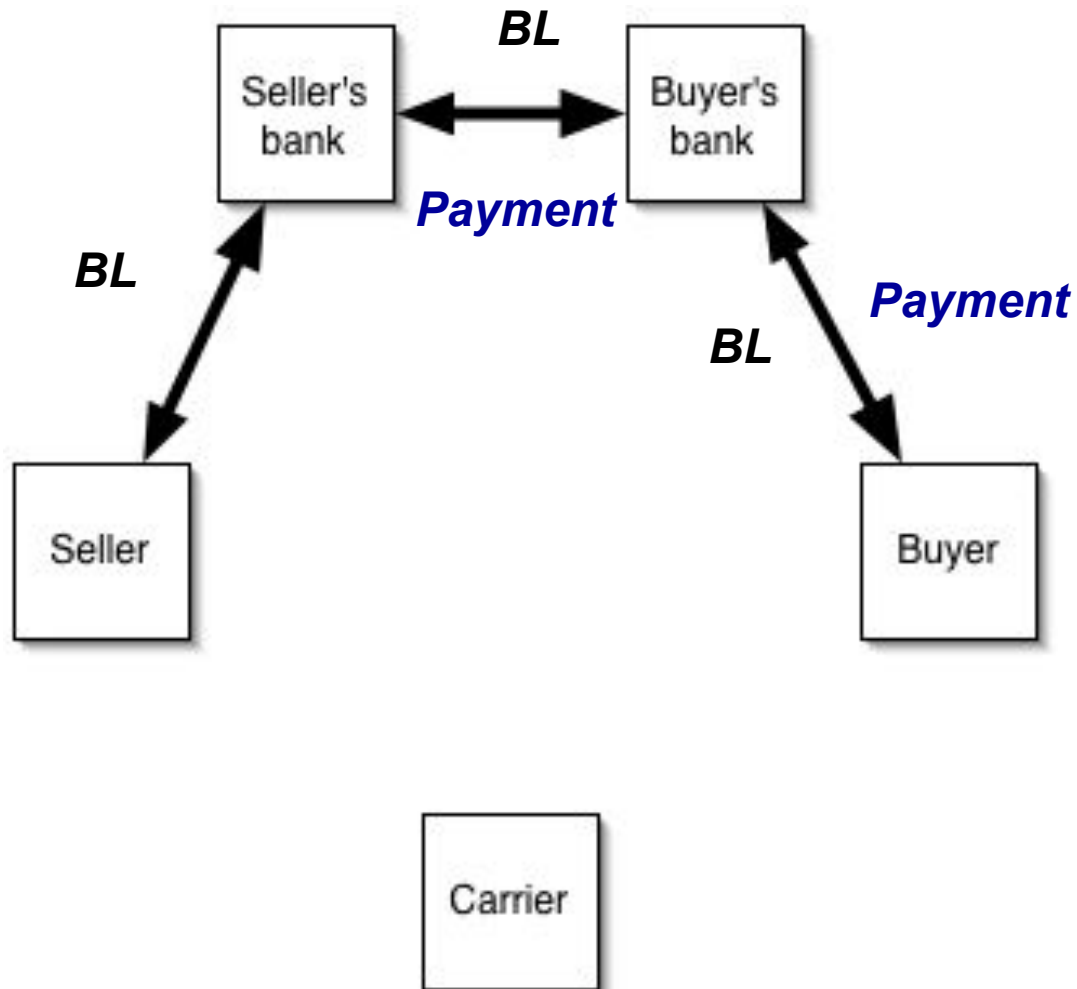
**1. After a contract is concluded between buyer and seller, buyer's bank supplies a letter of credit to seller**



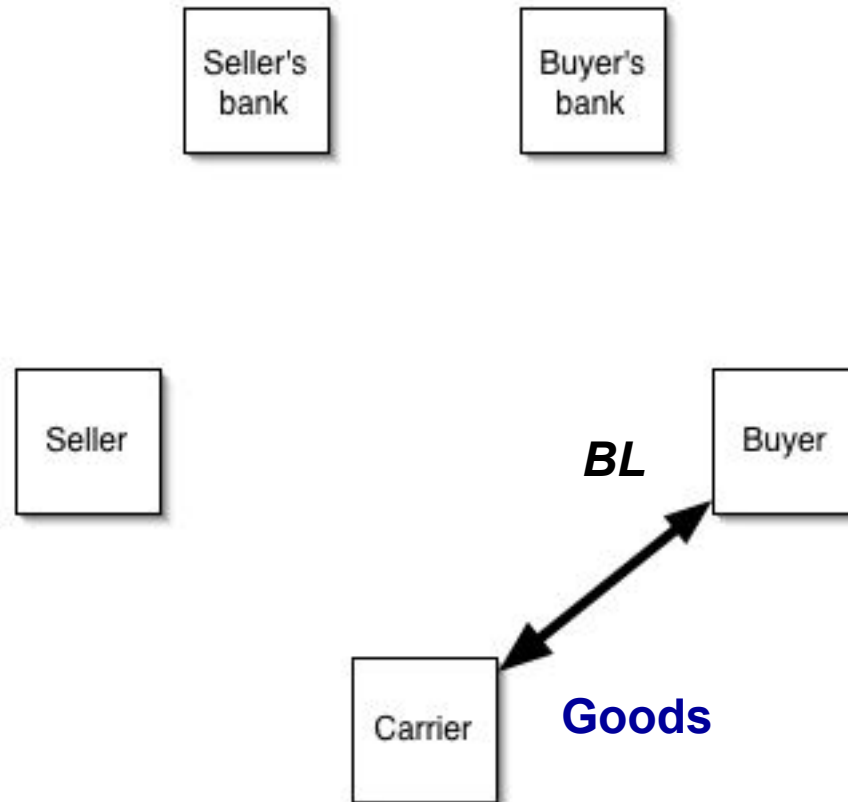
## 2. Seller consigns the goods to a carrier in exchange for a bill of lading



**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



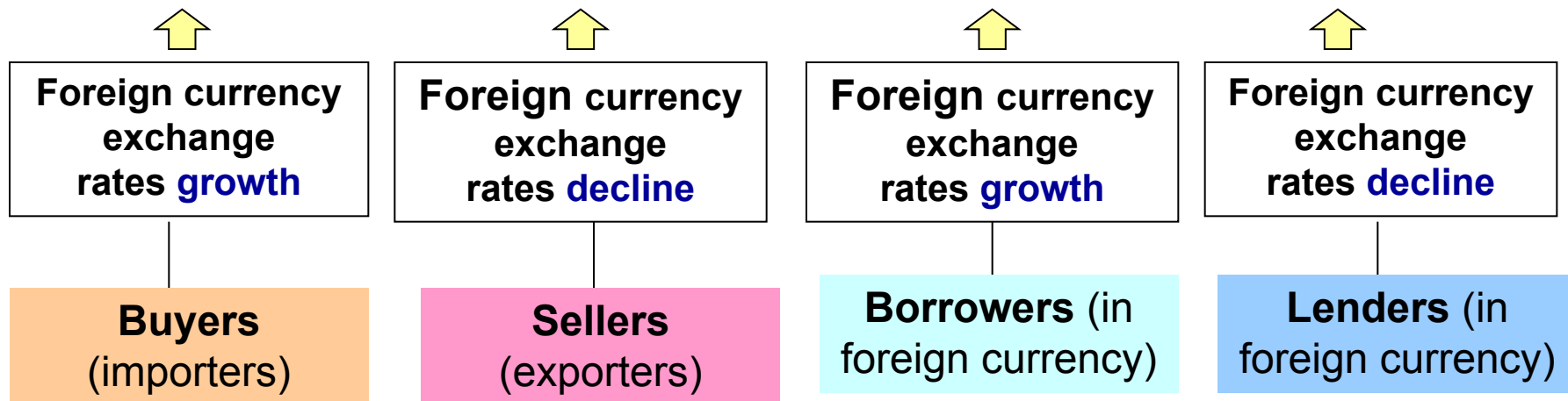
# Exchange rate exposure

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.

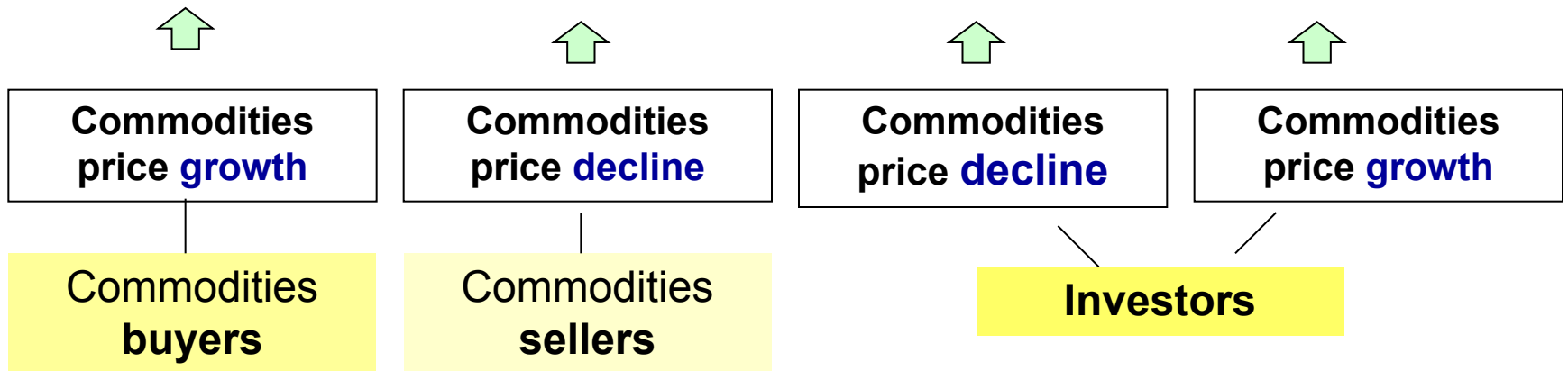
# Participants of the financial markets and their interests

## Currency Markets



# Participants of the financial markets and their interests

## Commodity Markets



## Credit Markets



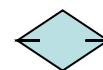


# Currency appreciations and depreciations

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	
	£	\$
<b><u>Now:</u></b> 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
<b><i>Net cash flow</i></b>	<b><i>0</i></b>	<b><i>0</i></b>
<b><u>Month 2</u></b> Repay £ loan with interest	- 253,7	
Receive payment on \$ loan		+440
Pay for properties		- 440
<b><i>Net cash flow month 2</i></b>	<b><i>- 253,7</i></b>	<b><i>0</i></b>

# Minimizing contractual risks

## Method 2. Buy dollars forward

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

Cost of hedging = Forward rate – Expected spot rate

# Currency forward contracts and rates

Buyer

Forward rate = \$ 1,6845/ £

Seller

Period = 1 month

\$0,0655

Pay-off per £ in \$

Pay-off per £ in \$

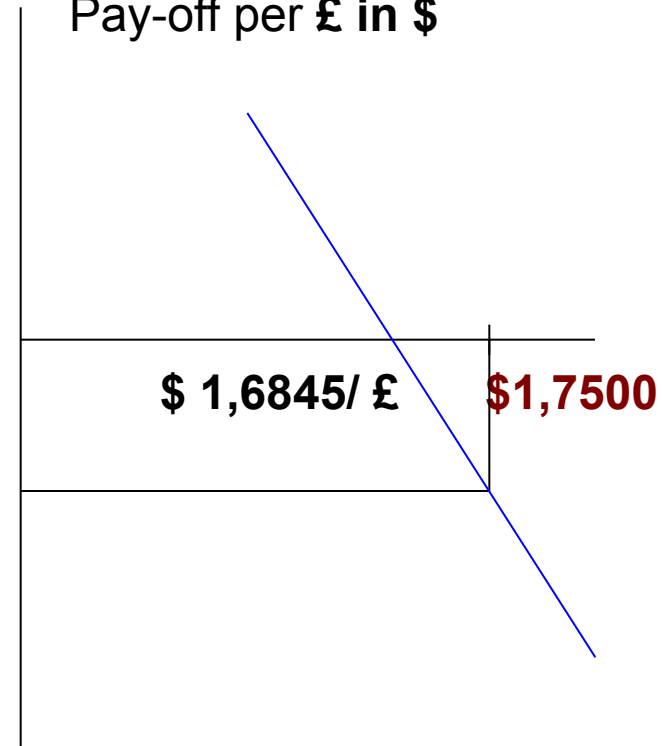
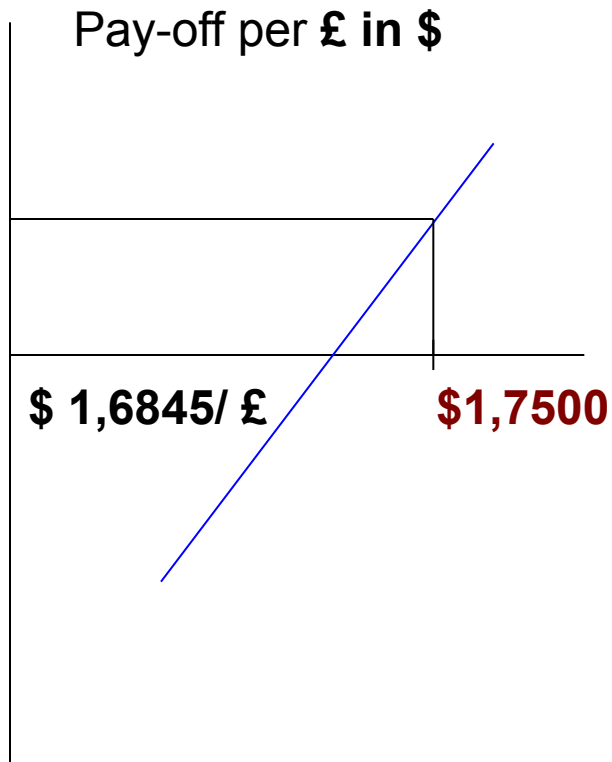
\$ 1,6845/ £

\$1,7500

\$ 1,6845/ £

\$1,7500

- \$0,0655



# Forward premium

## Fair Forward Exchange Rate

$$= \text{Spot rate} * (1 + R_{\text{for}}) / (1 + R_{\text{home}})$$

*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 =  $1,7241 * 1,05 / 1,06 = \text{SFr } 1,7078 / \$$

**Price of Forward Exchange Contract** (in %)

$$= (\text{Forward price} - \text{Spot price}) / \text{Spot price}$$

# 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 floating rate bonds** (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 less than 8%. Dealer pays LIBOR \* 8% if rates higher than 8%.**

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

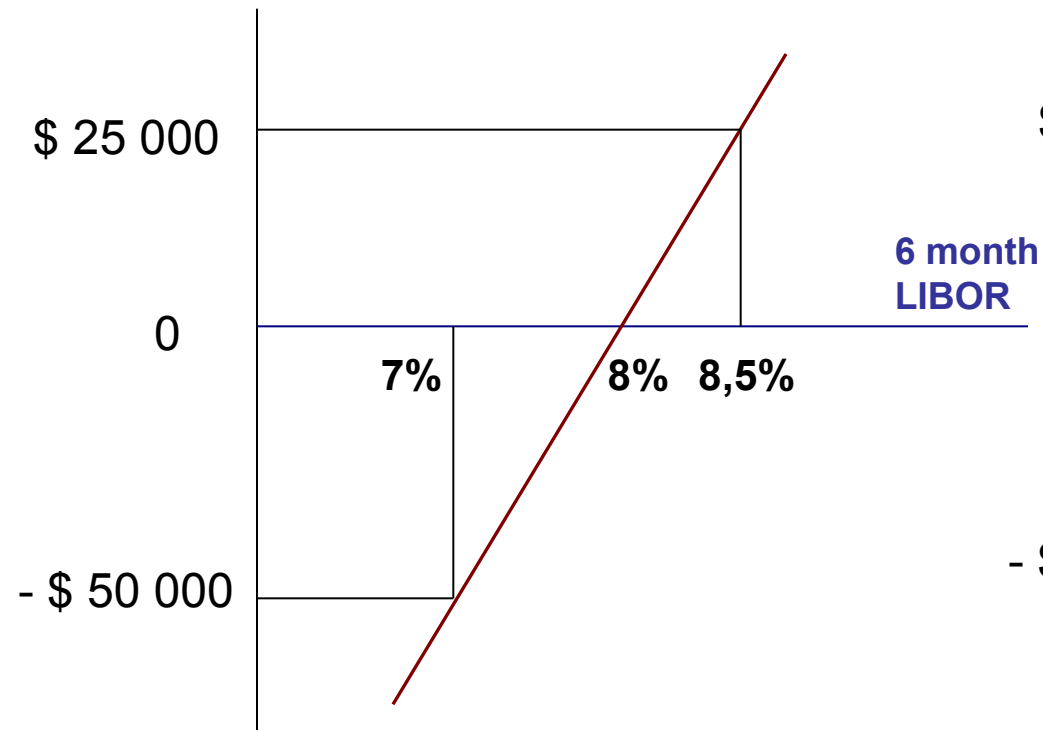
Interest rate swap can **transform floating rate bonds** into synthetic **fixed rate bonds**



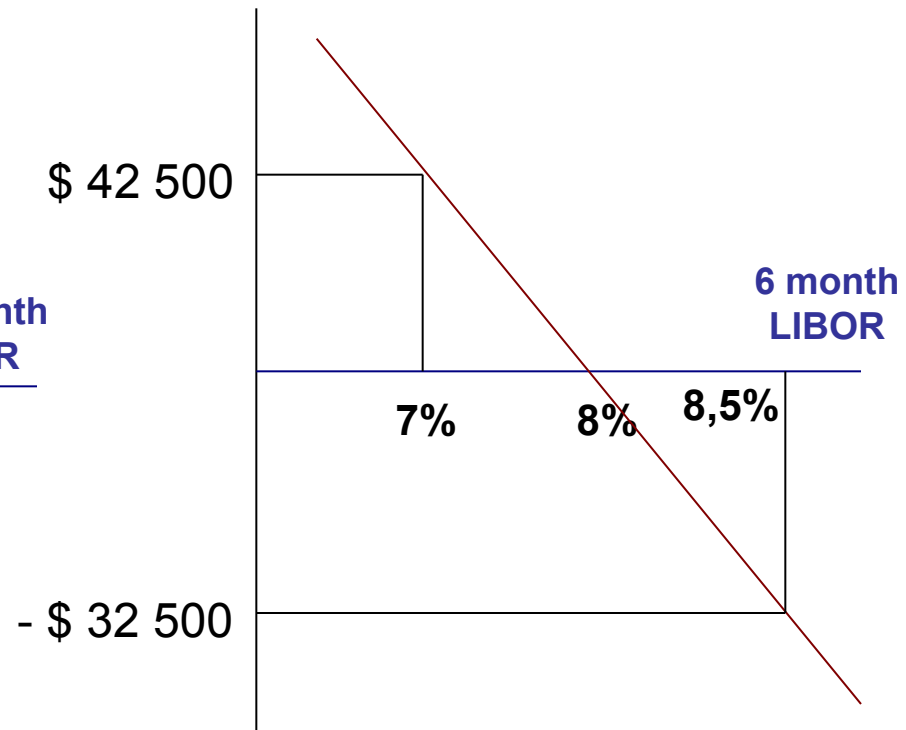
# Fixed for floating swaps

Notional principal = \$ 10 mln

Semi annual net CF for fixed rate payer, \$



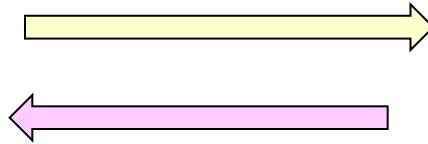
Semi annual net CF for floating payer, \$



# 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

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

**8% rate, 10 years**

**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:  $\$ 7 \text{ mln.} * 0,08 \div 2 = \$ 280 \text{ 000}$   
 $* 1,7 = 400 \text{ 000 EUR}$

At the end of 6 months German  
Comp pays:  $\text{€ } 10 \text{ mln.} * 0,08 \div 2 = \text{€}$   
 $400 \text{ 000} * 0,7 = 280 \text{ 000 EUR}$

# Risk Hedging, Risk Management and Value

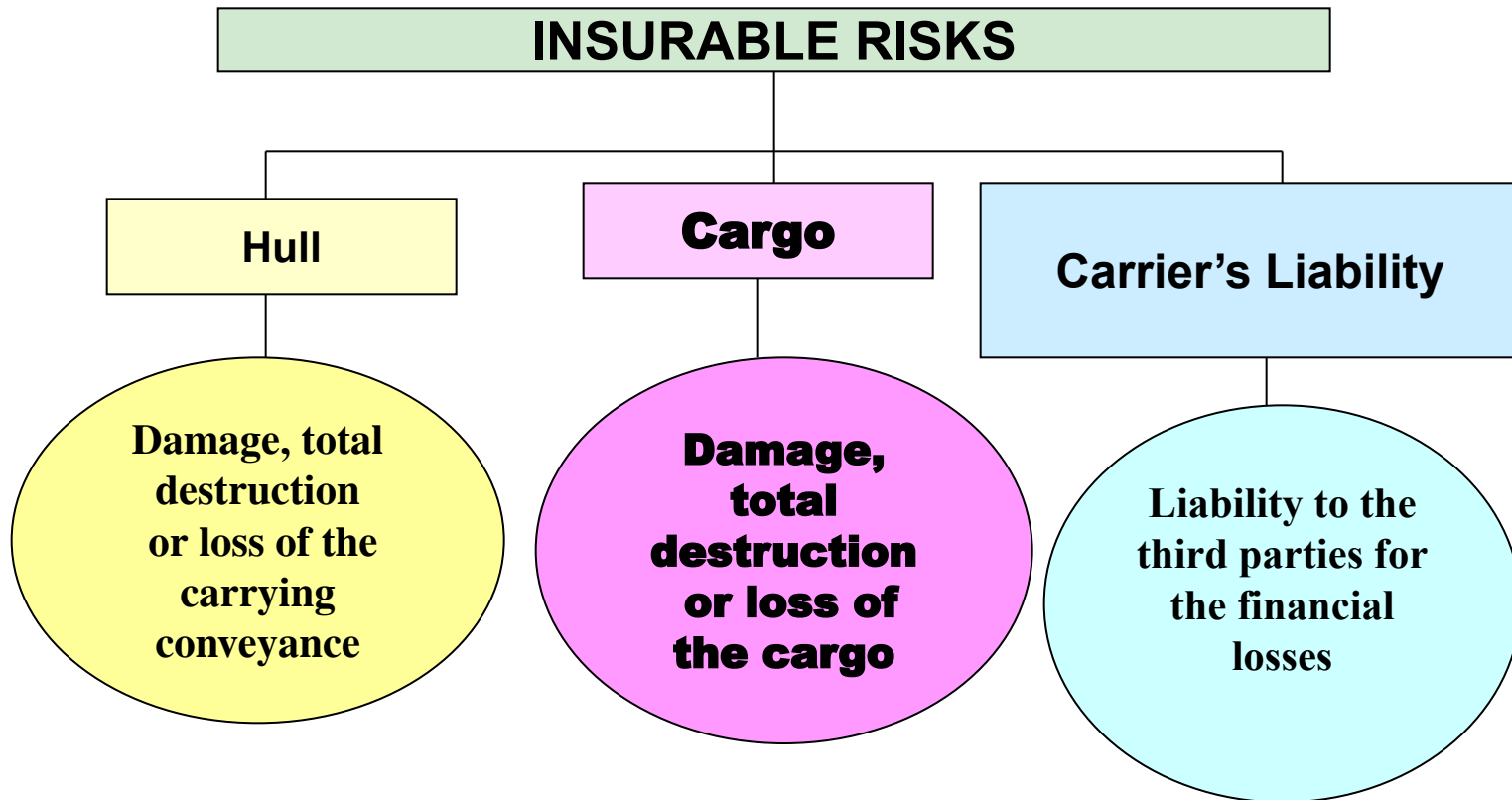
Valuation Component	Effect of Risk Hedging	Effect of Risk Management
Costs of equity and capital	Reduce <u>cost of equity</u> for private and closely held firms. Reduce <u>cost of debt</u> for heavily levered firms with significant distress risk	May increase costs of equity and capital, if firms increases 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 returned by the insurer to the client (minus insurance loading)**

## **Open cover /**

# **Генеральный полис (договор) страхования**

### **Applicable when:**

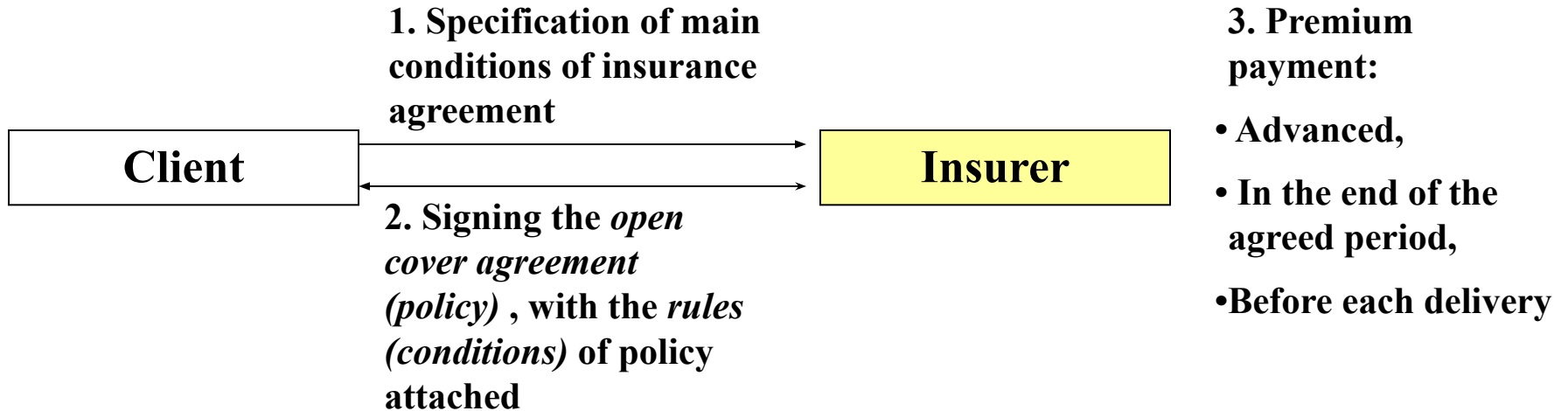
- **Is issued once by the insurer under contract to cover all shipments (of cargo with similar characteristics) made by the exporter over a period of time (one year usually)**

### **Open policy conditions:**

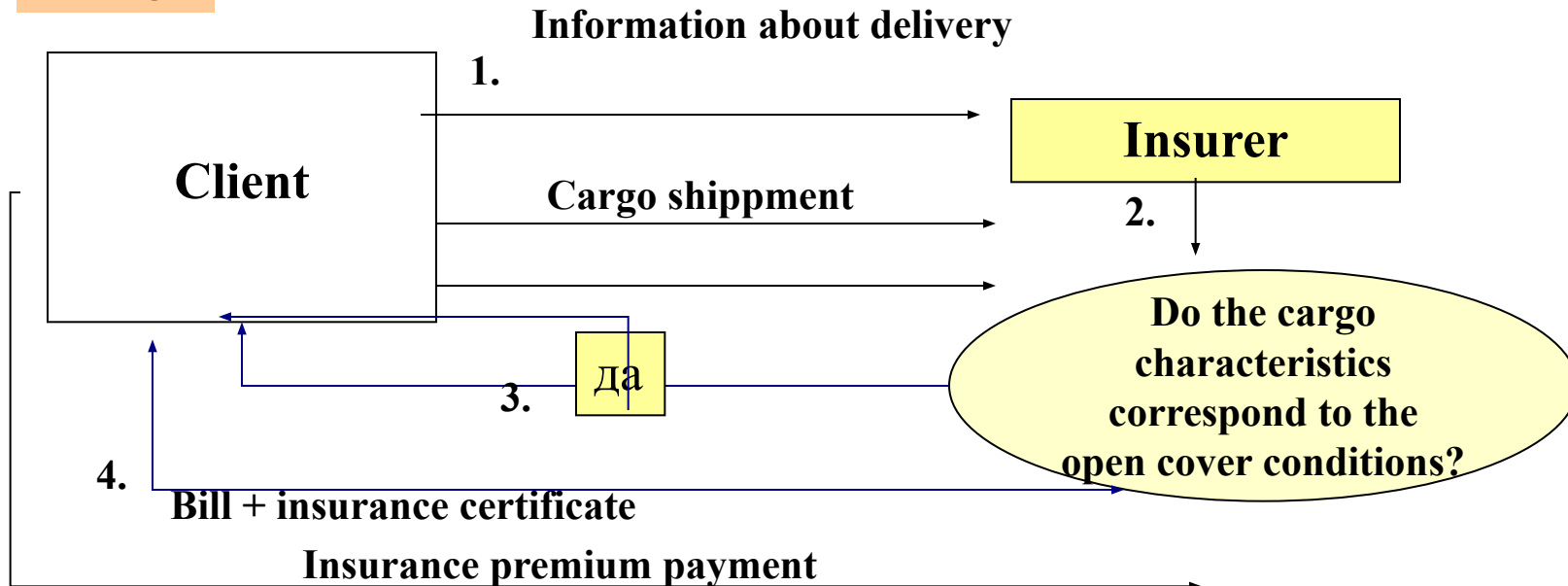
- ✓ **Cargo characteristics;**
- ✓ **Shipments periods and transportation routes;**
- ✓ **Client's loss statistics;**
- ✓ **Type of vehicle;**
- ✓ **Limits of sum insured by one vehicle;**
- ✓ **Forecasted trade turnover of a company during the year ;**
- ✓ **Insurance conditions & rates**

# Open cover

## I Stage



## II Stage.



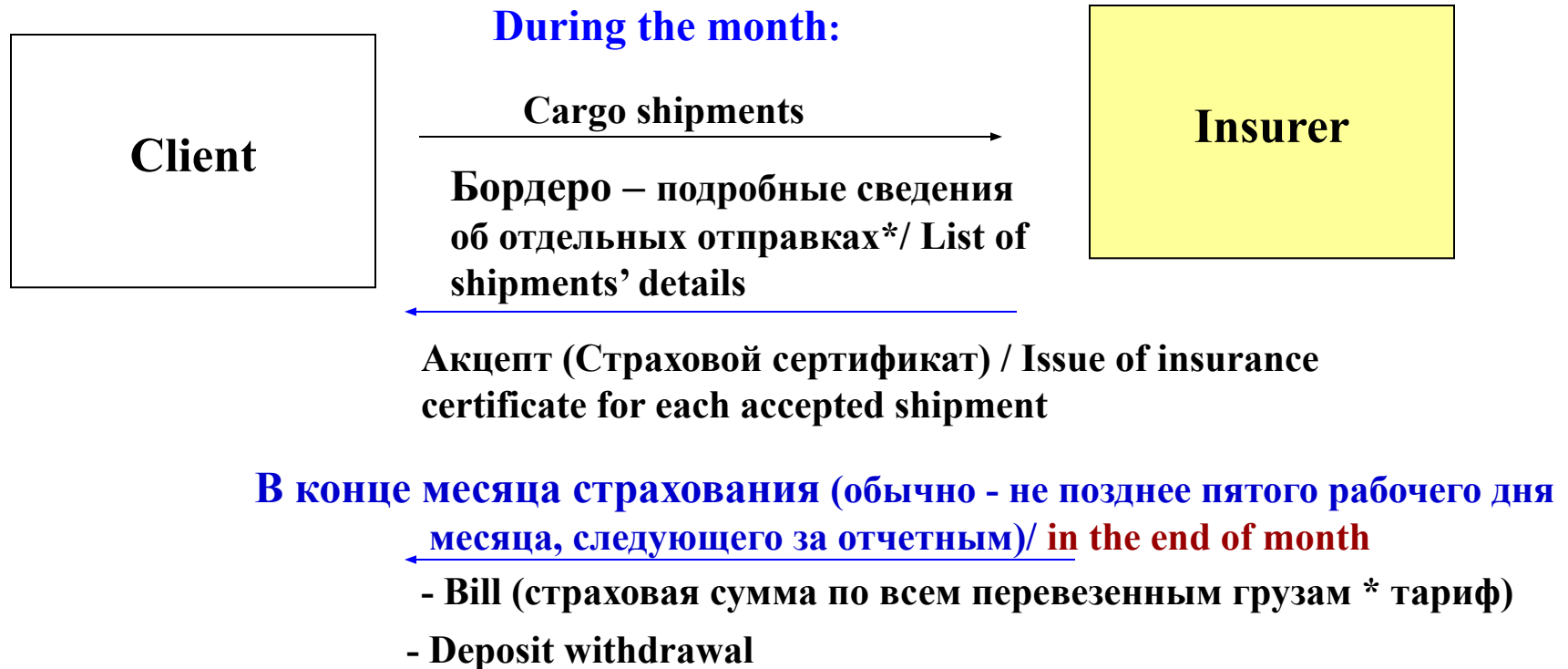
# Sum insured (cargo)

- **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)



\* - 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% cheaper 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 Underwriters)

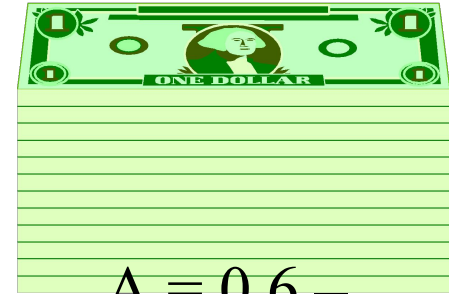
Insurance  
premium  
(in % of the  
Sum  
insured)



C = 0,2 –  
0,4%

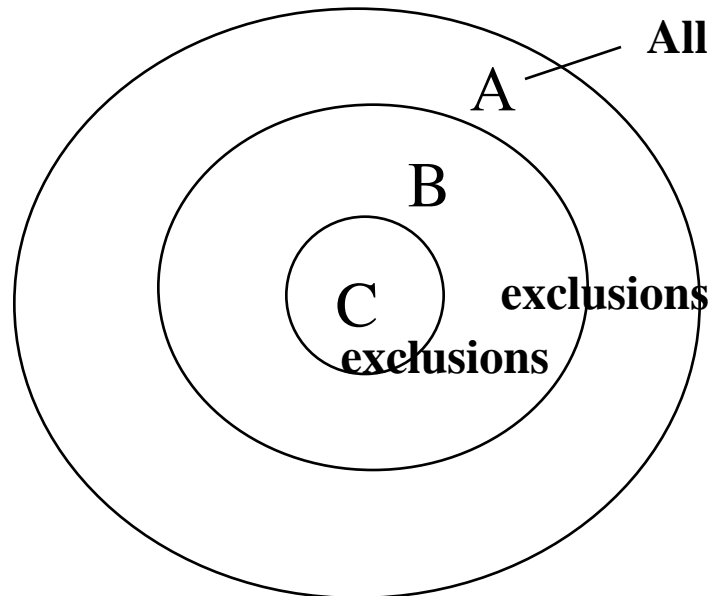
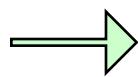


B = 0,4 –  
0,6%



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 thereof as a result of the listed risks + (2) + (3)

# Comparative analysis of ICC coverages

<i>Loss Caused By or Resulting From:</i>	<i>Free of Particular Average</i>	<i>With Average</i>	<i>All Risks</i>
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
<b>Auto transportation</b>	8,33 SDR*	+	The convention on the agreement of the international road transportation of cargoes (КДПГ 1978)
<b>Railway transportation</b>	17 SDR	+	The convention on the international rail transportation (КОТИФ 1980)
<b>Sea transportation</b>	2 – 2, 5 SDR	-	The Hamburg rules (1978) Amendments to the Hague Rules / to the Visbijsky report
<b>Aviation transportation</b>	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 <sup>1</sup>	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	<u>0.632000</u>	
			<b>1.512531</b>	
U.S.\$1.00 = SDR			<b>0.661143<sup>2</sup></b>	<b>0.021</b>
SDR1 = US\$			<b>1.51253<sup>4</sup></b>	

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 ?

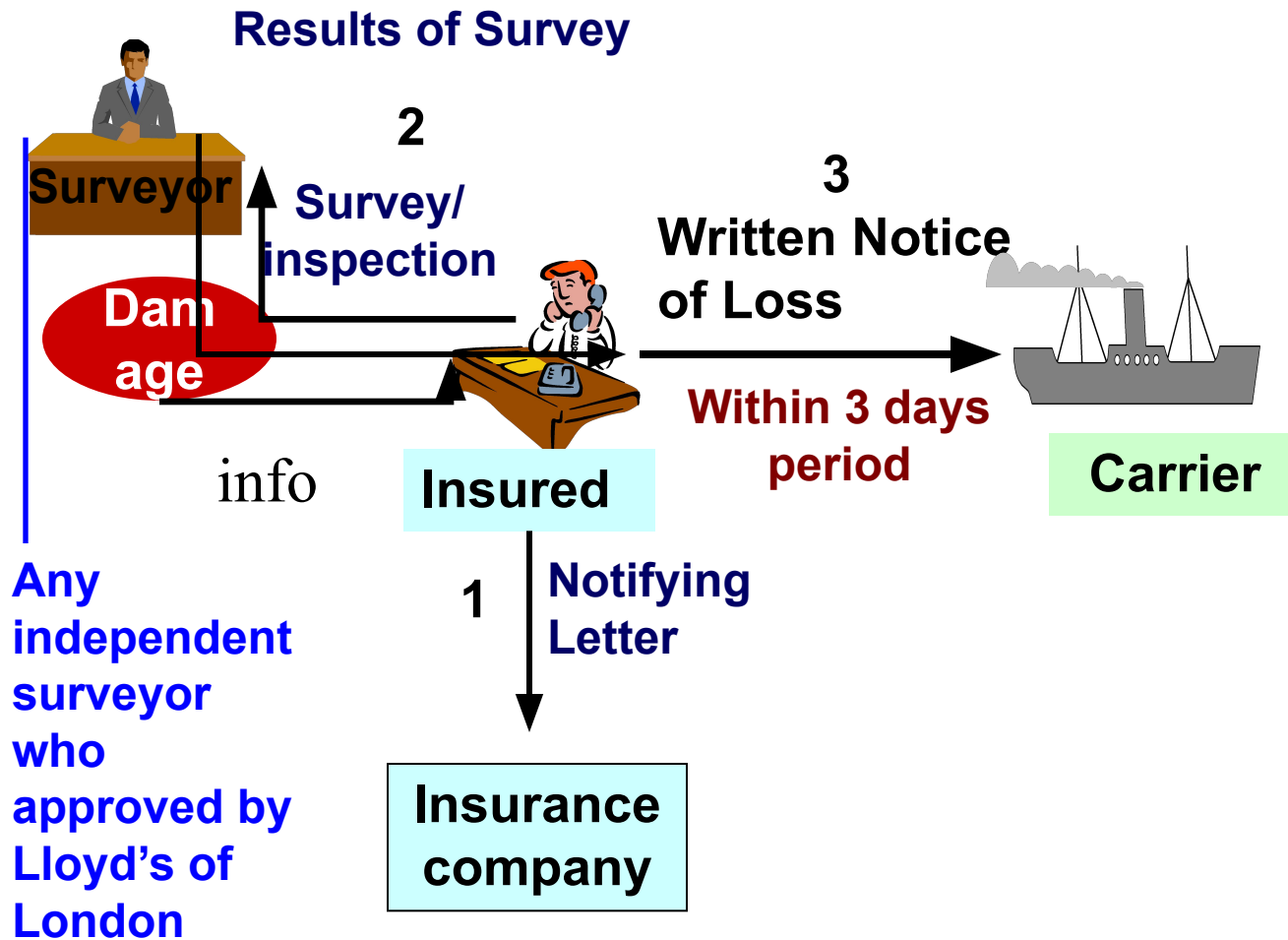
Confirm the fact, place and reasons of the losses to prove the fact of the insurable event

Confirm the cost and ownership of the property to prove the fact of the insurable interest

To define and to prove the amount of loss

# 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

<i>Unforeseen events</i>	<i>Political decisions</i>
Revolutions  Power change  Change of the government  War risks  Damage caused to employees of the company abroad	<p><u>1. Pure political</u> Goods confiscation; trading embargoes; a wrongful response of a guarantee changes in legislation; refusal of the declared intentions; contract cancellation by the private counterparty</p> <p><u>2. Risks of administrative character</u> Licence withdrawal; an obstacle to carrying out of export or import operations</p> <p><u>3. Risks of macrolevel</u> An interdiction for converting operations; cardinal changes in economic policy</p> <p><u>4. Risks of microlevel</u> 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</p>

# 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 counter-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.

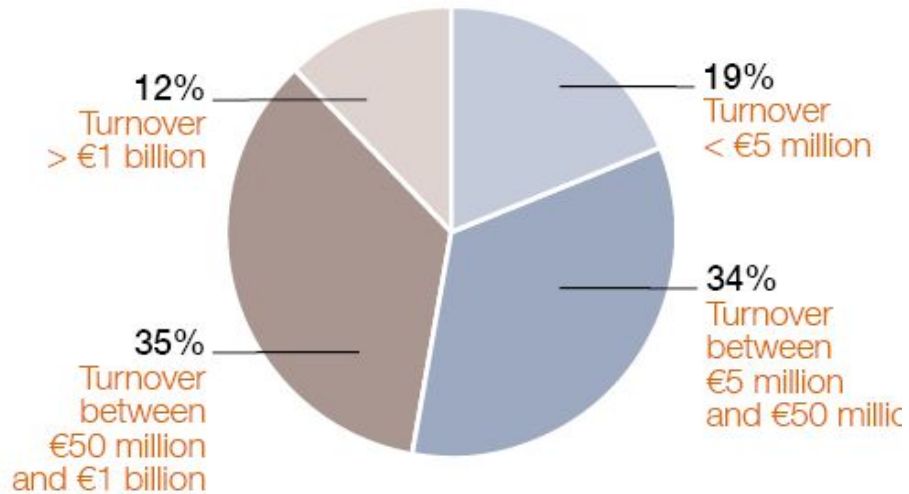
# Biggest credit insurers/guarantee providers in Europe

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



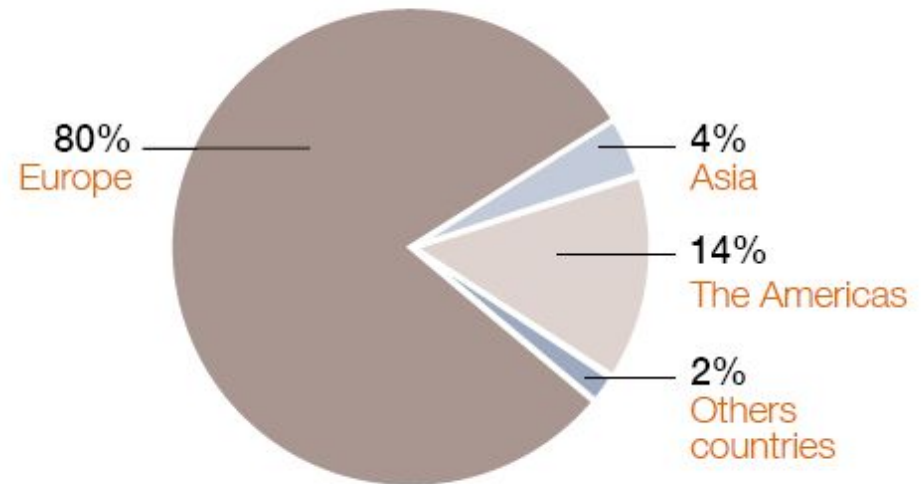
# Coface

## Coface's portfolio segmentation by size of companies

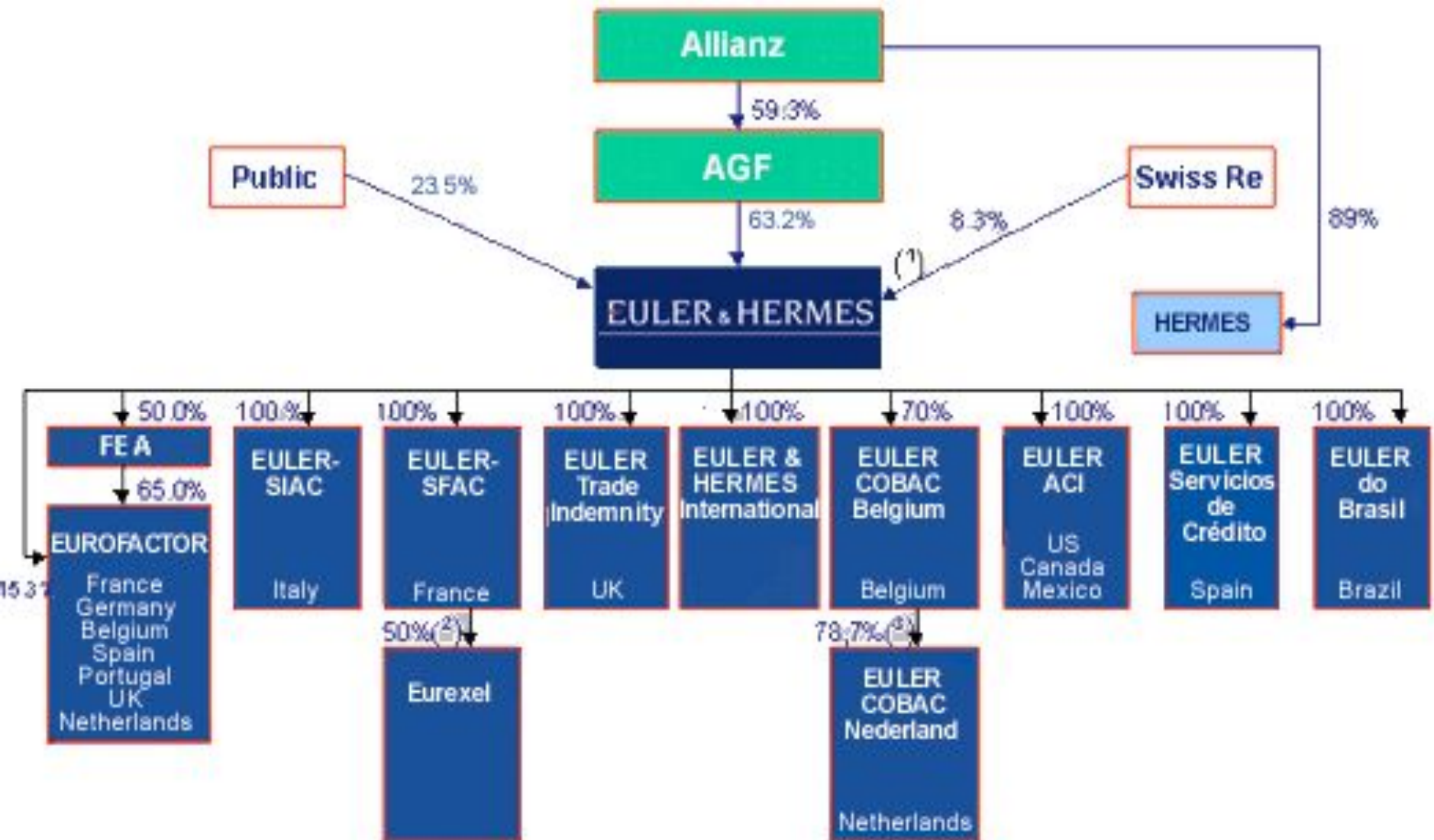


## Distribution of Coface's clients by geographical zone\*

\* 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 political base rate and a commercial surcharge.

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 +	political +	political +	political +
		commer cial	commer cial	commer cial	commer cial
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

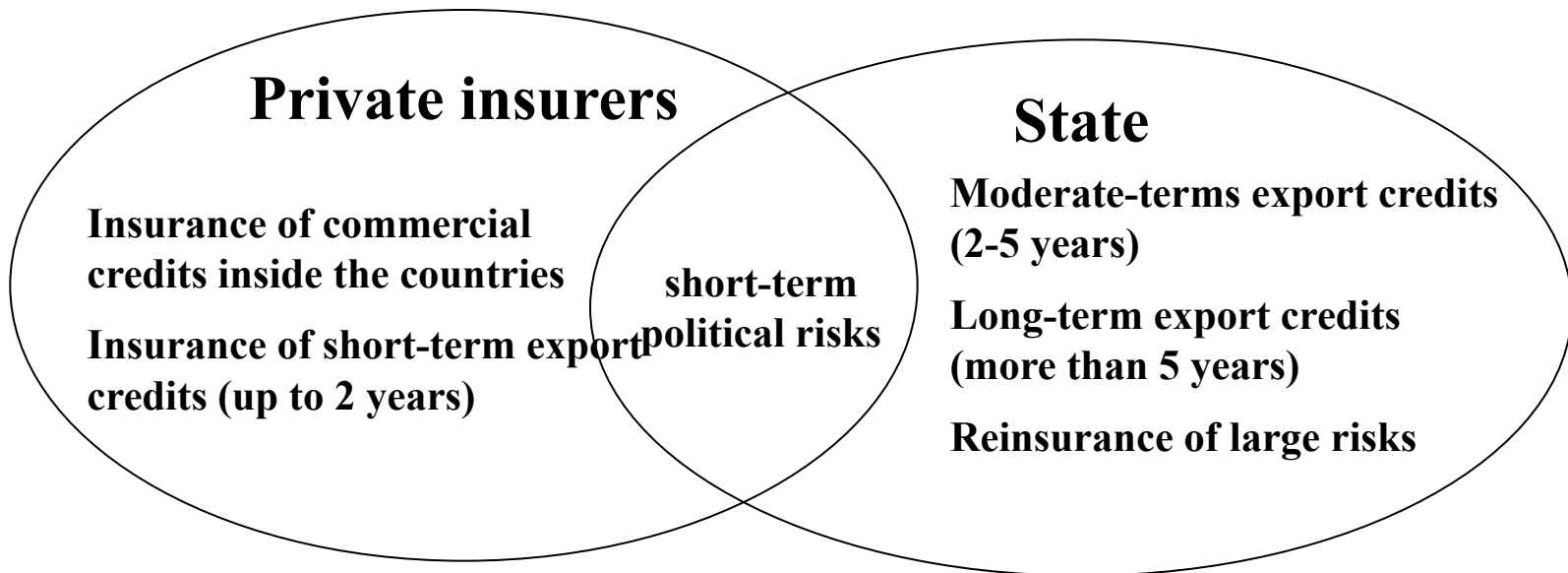
# Credit rating agencies

- **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

	<i>Share of market in 2005</i>
<b>Leading insurers:</b> -Euler Hermes -Atradius -Coface	<b>87%</b>
<b>Others</b>	<b>13%</b>

# **Commercial insurance companies, operating on the export credit insurance market**

**Lloyds of London (Robert and Hiscox syndicate) - UK**

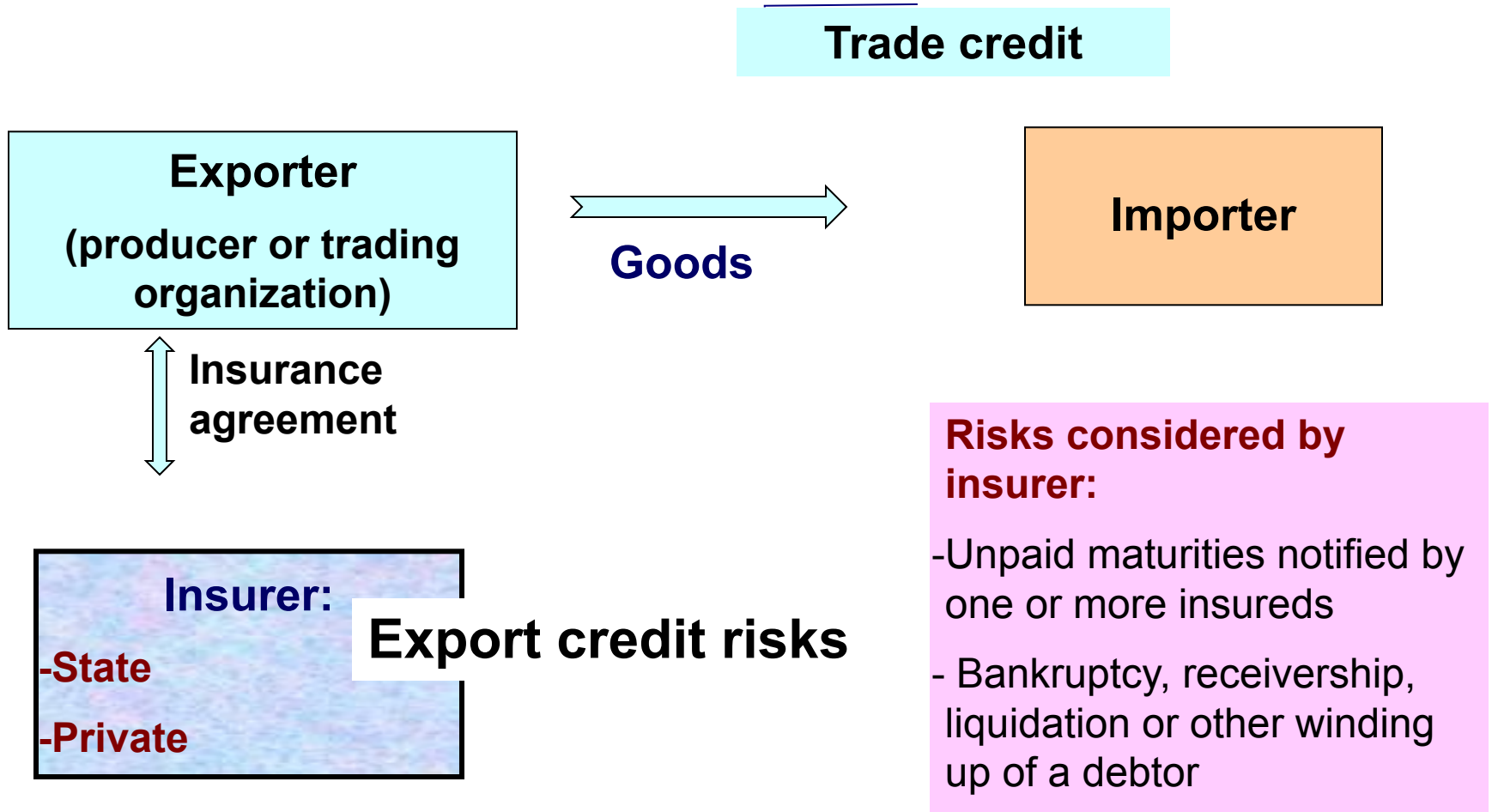
**American international group (AIG) - USA**

**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

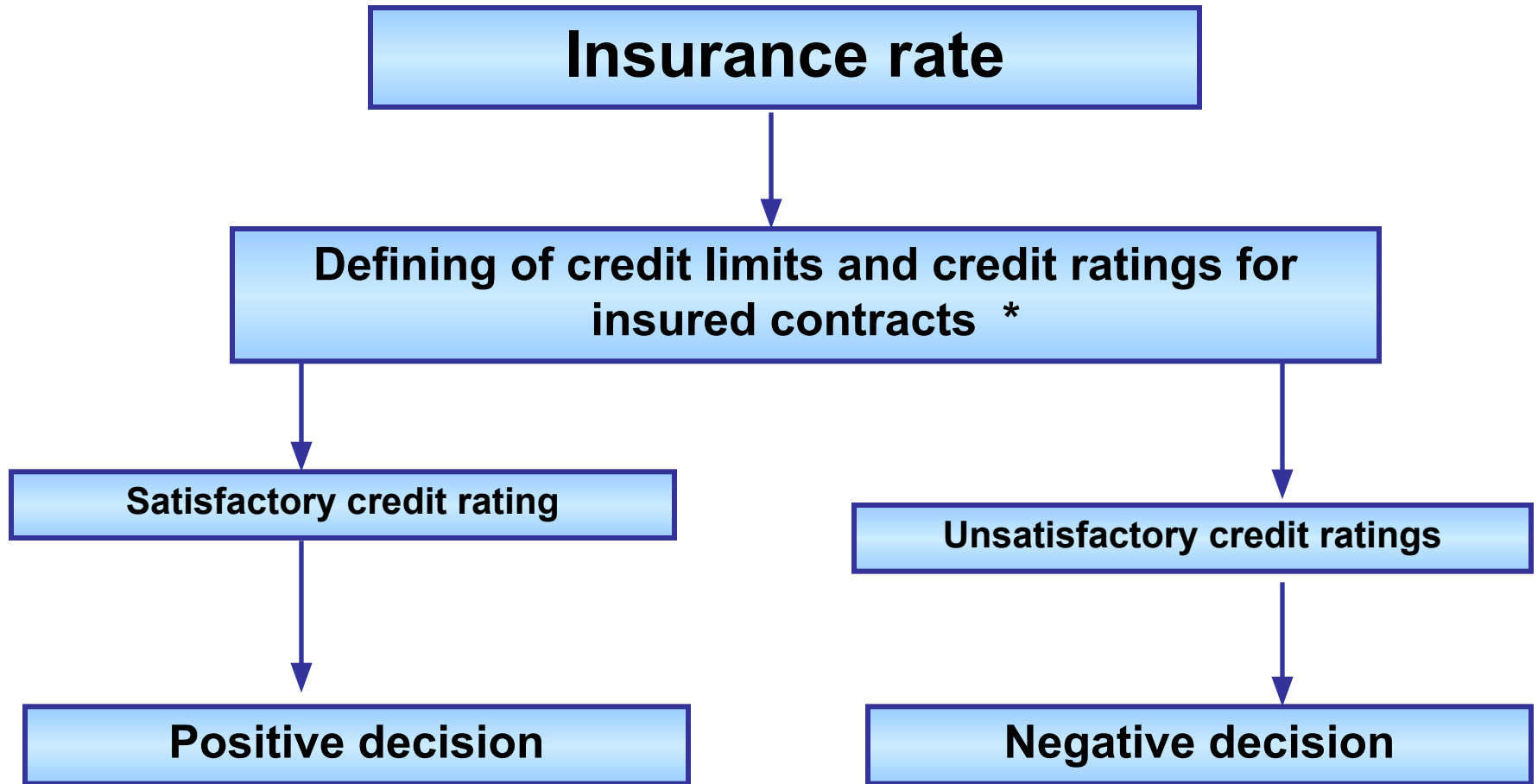
Risk  
analysis

Decision about  
taking for  
insurance the  
risk

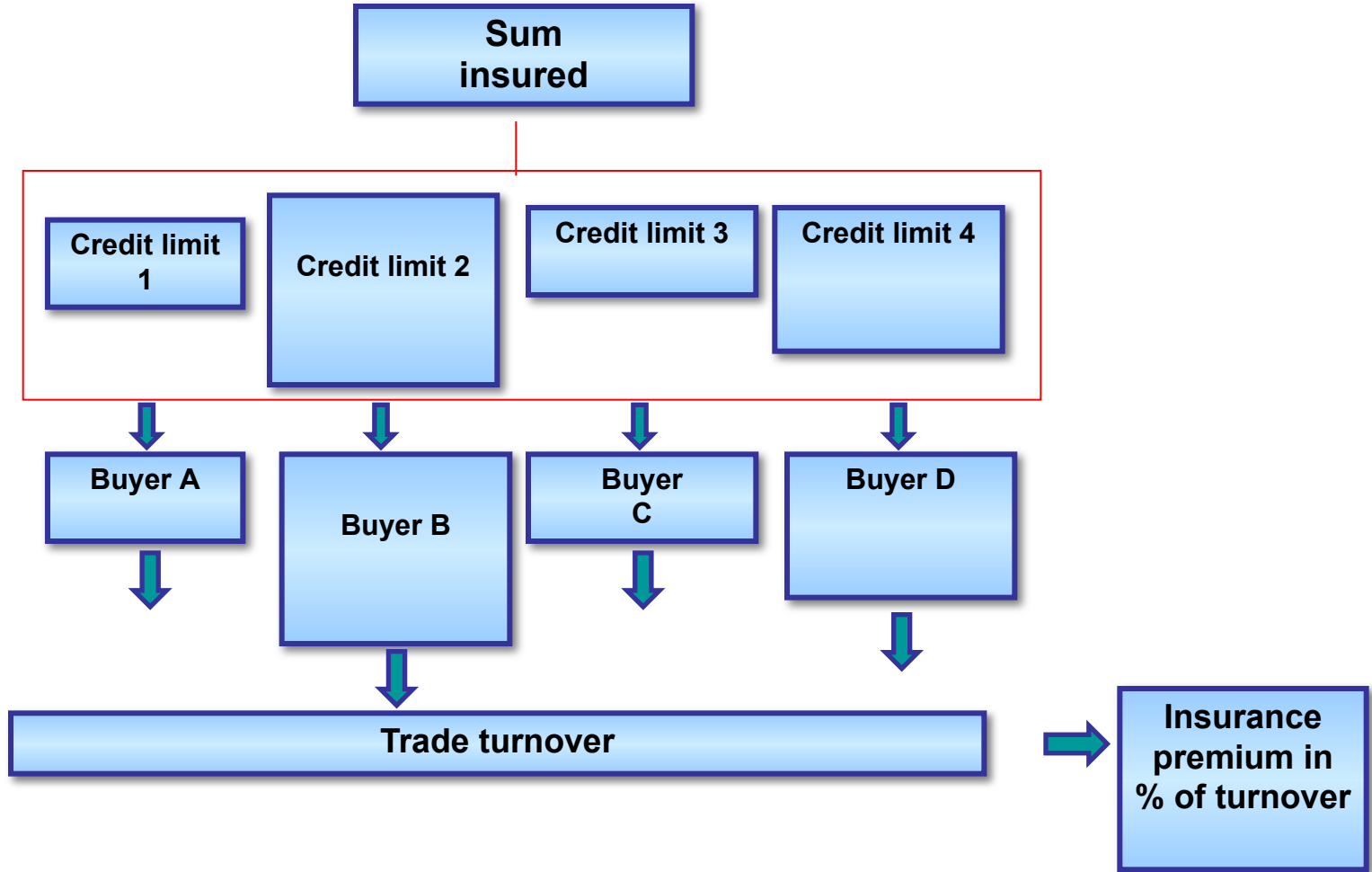
Declining application

Accepting application

# Factors, influencing on the decision about insurance

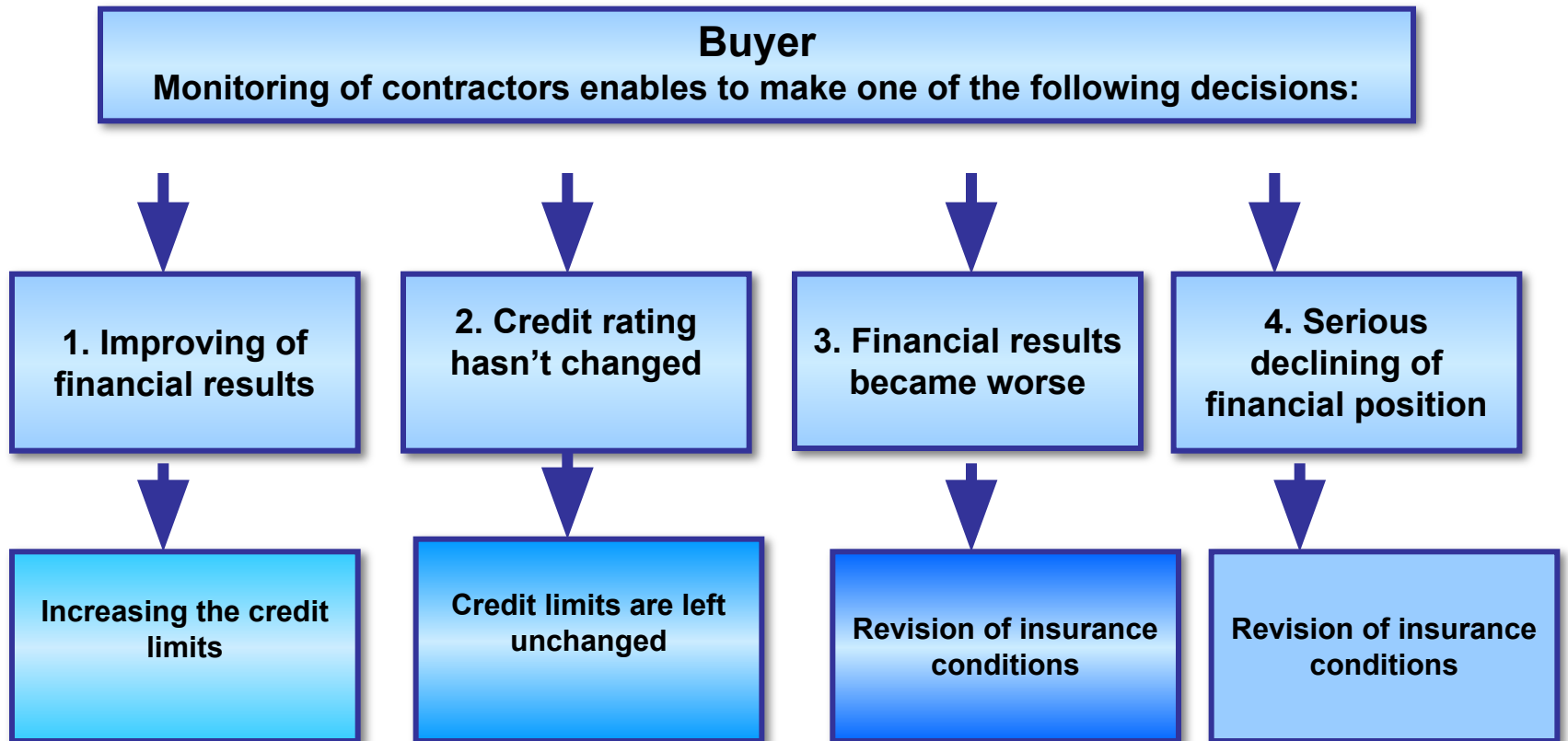


# Setting up the sums insured





# Corrections of the sums insured



# 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**

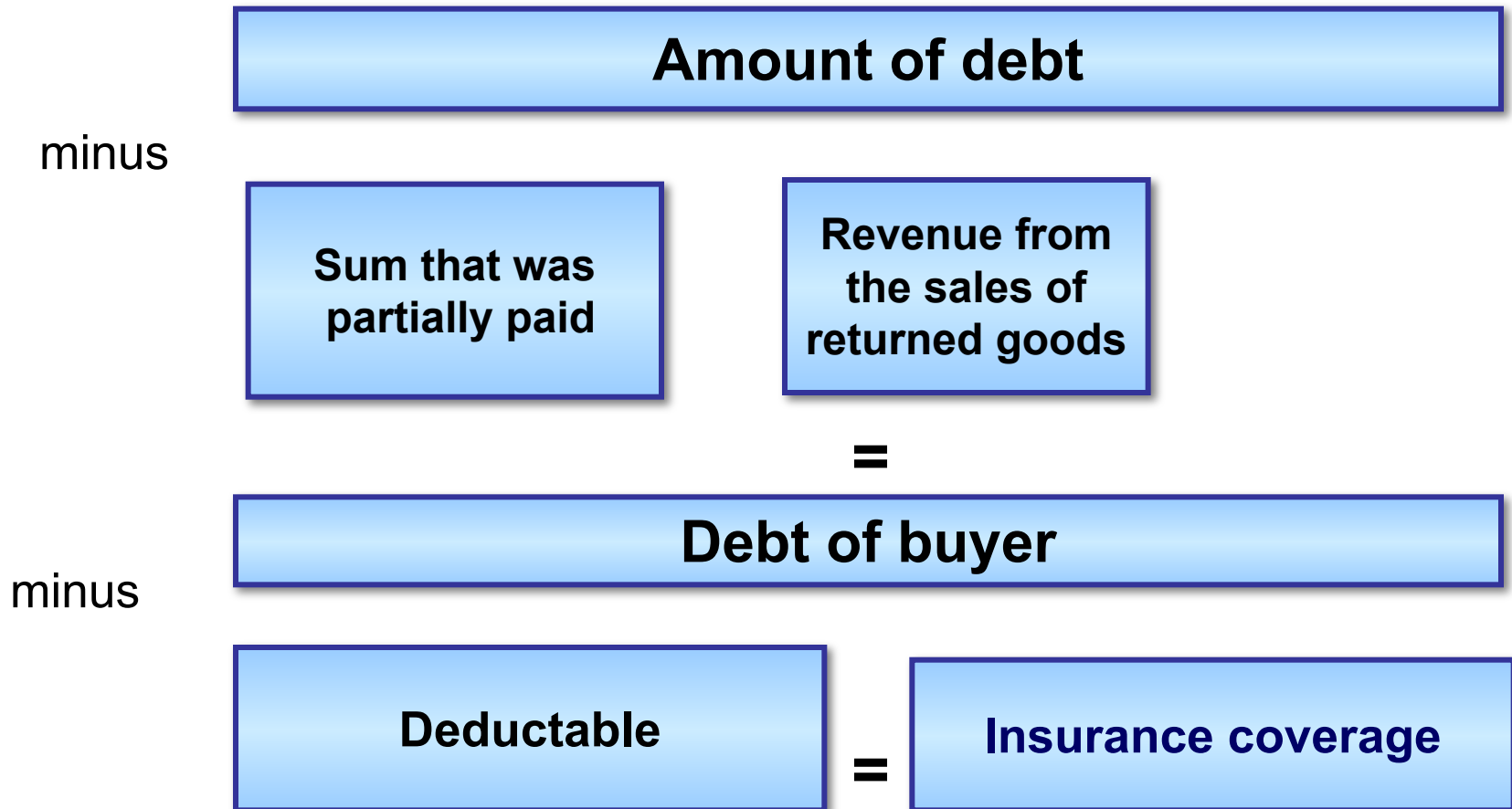
**Insurance rate**

A diagram illustrating the factors influencing the insurance rate. At the top center is a blue box labeled 'Buyer'. Below it are three boxes: a green box on the left for 'Risk class', a yellow box in the middle for 'Deductable', and another yellow box below it for 'Trade turnover'. A bracket on the right side groups the 'Deductable' and 'Trade turnover' boxes, with a line pointing to a pink box labeled 'Insurance rate'.

```
graph TD; Buyer[Buyer]; Risk[Risk class]; Deductable[Deductable]; Trade[Trade turnover]; Insurance[Insurance rate]; Buyer --- Risk; Buyer --- Deductable; Buyer --- Trade; Deductable --- Insurance; Trade --- Insurance;
```

# Insurance coverage calculation

Loss calculation scheme:



# Example of coverage table (credit limits)

<b>Credit Rating</b>	<b>Sum insured</b>	<b>If Credit Loss</b>	<b>Coverage</b>
<b>AAA</b>	<b>\$ 50 000</b>	<b>\$ 70 000</b>	<b>\$ 50 000</b>
<b>AA1</b>	<b>\$ 40 000</b>		
<b>BBB</b>	<b>\$ 30 000</b>		
<b>BB1</b>	<b>\$ 20 000</b>		

# Coinsurance and Loss

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

## 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)



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





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

	Min risk <i>Минимальный риск</i>					Max risk <i>Высокий риск</i> ^				
	A+	A	A-	B+	B	B-	C+	C	C-	
<b>Авиатранспорт</b>					Западная Европа	Япония Восточная Европа	Северная Америка			
<b>Автомобильная промышленность</b>		Япония		Восточная Европа Азия Латинская Америка		Западная Европа		Северная Америка		
<b>Химическая промышленность</b>		Япония Азия	Западная Европа Северная Америка	Восточная Европа Латинская Америка						
<b>Производство одежды</b>			<b>Азия</b>		Восточная Европа	Латинская Америка		Северная Америка	Западная Европа Япония	
<b>Строительство</b>			Восточная Европа Азия	Западная Европа	Северная Америка Латинская Америка	Япония				
<b>Электроника</b>		Северная Америка <b>Азия</b>		Япония	Западная Европа					
<b>Информационные технологии</b>				Восточная Европа Азия Латинская Америка		Западная Европа Северная Америка Япония				

# International investments' insurance agencies

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

**MIGA Member Countries (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.**