Is this the most OVERLOOKED line in INSURANCE?

Michael Hartsman, the manager of Trade-credit at Firstbrook, Cassie & Anderson Insurance, explains the intricacies of this product – a lucrative and largely overlooked market

Michael Hartsman brings a unique background to the insurance industry – a talent for finances that has served him well in the world of trade-credit insurance.

"I am probably one of the very few insurance guys around with a financial background," says the manager of trade-credit at Firstbrook, Cassie & Anderson. "My whole experience has been in credit. I was a director of a billion-dollar company, handling their accounts receivable on a national basis for years. But I felt like I was at the top of my career there, so I decided to do some freelance work in trade-credit insurance, while I applied for my RIBO licence."

When Hartsman entered the world of trade-credit insurance, it wasn't exactly a spectacular start.

"When I studied for my RIBO, there wasn't one question about trade insurance," he remembers. "When I failed the exam – I think you need 75 per cent to pass – I phoned RIBO and asked what I needed to do to improve."

It didn't take long for Hartsman to get a tutor and pass the RIBO exam, joining FCA Insurance. It has been 15 years and he has never looked back.

"When I started with FCA I had to start from scratch. I had zero customers," he says. "Today I make a decent living – believe me."

Although a lot of people entering the insurance field tend to steer clear of the trade-credit field, it is a natural fit for Hartsman.

"I know a lot of people in the industry, and there are a lot of people out there who won't get into it because they don't understand it," he says. "They will send out an application and it will come back declined. I know how to put together a policy, and I have good relationships with the credit insurers. I know how to structure a policy that makes sense to them and works for them. You've got to understand credit – it really has nothing to do with insurance."

Hartsman's years working as a national credit manager with Merisel went a long way to his becoming a top-flight Trade-credit insurance broker.

"I can read credit reports; and a background in credit administration has really helped me," he says. "Understanding how a credit department is run has proven invaluable."

And that can be a tough wall to scale to understand the business, says Hartsman – for those just entering the business, trying to understand how credit works without an 'insurance bible' to use as a reference.

"There's no book out there," he says. "In the case of a house fire, and the cat dies, and somebody asks 'How is the cat covered under my insurance policy?' they look it up in the book. But with credit insurance, it really helps to know how the credit and collection industry works. It is really a non-insurance business."

PROTECTION AGAINST OUTSTANDING RECEIVABLES

Trade-credit insurance can best be described as protection against outstanding receivables.

Trade-credit insurance protects suppliers against the risk of non-payment of goods or services by their buyers. This may be a buyer situated in the same country as the supplier (domestic risk) or a buyer situated in another country (export risk). The insurance covers non-payment as a result of insolvency of the buyer or non-payment after an agreed number of months after the due-date, often referred to as protracted default.

It may also insure the risk of non-payment following an event outside the control of the buyer or the seller, for example political risk cover, or the risk that money cannot be transferred from one country to another.

Trade-credit insurance ensures against the risk that a buyer does not pay. It can also cover the risk that a buyer pays very late. A buyer will not pay after he has been declared bankrupt, insolvent or has a similar legal status. Similarly, buyers sometimes opt for a bankruptcy protection arrangement, which allows them to delay payments for an extended period. Both instances are covered under a trade-credit insurance policy.

These policies can include a wider range of cover, depending on the circumstances. Some policies consider a delay in payment also to be an insolvency (so-called Protracted Default cover). If a buyer does not pay, the trade-credit insurance policy will pay out a percentage of the outstanding debt. This percentage usually ranges from 85 per cent to 90 per cent of the invoice amount, but may be higher or lower depending on the type of cover that was purchased.

Trade-credit insurance policies are flexible and

allow the policyholder to cover the entire portfolio or just the key accounts against corporate insolvency, bankruptcy and bad debts. The most common type of cover is so-called Whole Turnover Cover, which covers all buyers of the policyholder.

One of the advantages of insuring receivables is the higher percentages that can be obtained from the banks.

"The beauty of credit insurance, is you can be selling anywhere in the world, and you can be covered. If you are selling in China, you can be protected."

Michael Hartsman

"A lot of banks today want their clients to have insured receivables," says Hartsman. "A lot of people out there when they go to their bank for a loan or a line of credit, the bank gives them about 75 per cent of their receivables on their line of credit. But if you insure the receivables, you can get about 90 per cent. I have a lot of clients who don't care if they lose money, because they are getting more with their line of credit at the bank with insured credit."

DISCRETIONARY CREDIT LIMIT

Like other brokers – be it insurance or even mortgage – their true value is their insider knowledge, connections and ability to get the best deal.

"Take the discretionary credit limit, for example," says Hartsman. "Insurers can grant credit up to that limit without approval from the insurance company. Certain companies require a higher limit. Certain companies won't even give that limit. A broker can ensure that limit is in the policy."

And Hartsman is all too familiar with the argument that dealing directly with a credit insurer will "cut out the middleman" and save money.

"A lot of people think it is a better deal because of price, but they may not necessarily get the same policy that I can give them. I can actually give them more, because when I go in there they know that there are other insurance companies fighting for that price," he says. "Sometimes the insurance companies don't tell you everything. They don't lie, but they don't tell you everything."

A good example of this is non-cancellable credit limits, says Hartsman.

"I have some companies that will give non-cancellable credit limits, which is a really great feature for a credit manager. Any account that they approve they can't cancel. It can go bad, it can go bankrupt, but they can't cancel," he says.

The way it is priced out, says Hartsman, the customer will anticipate his sales – say $10 million. But if they make $11 million, then they are charged for that extra million.

"But that is if they buy a policy like that," he points out. "I can find them a policy that has a flat premium, that has no upcharge. A lot of brokers may not do that, but I am able to find that policy. So going direct is really not the best thing to do."

A rich vein of clients Hartsman has mined over the years has been those who have signed up with the Export Development Corporation (EDC).

"A lot of people are not aware that the EDC are typically 30 to 50 per cent higher in premium," he says. "If I had the EDC list, I'd be a millionaire."

Hartsman says he's pulled more clients away from the EDC than anywhere else.

"They used to be really good, because they took risks far greater than other companies," he says. "But I'm finding now that they aren't, but still charging oodles of money. People trust EDC because it is run by the Canadian government."

A true test of trust came during the American economic meltdown five years ago, says Hartsman – and one lender that shone was AIG.

"During the crisis of 2008, a lot of my clients were with AIG. Not one single client changed (left AIG) – and I had customers who had claims of seven figures, and they were paid without a hiccup," says Hartsman. "And they are still one of the largest financial companies in the world, and their stock is doing great today – and they've paid back the government.

"AIG proved they had enough reserves to handle that crisis."

POPULAR IN EUROPE

Credit insurance is still a relative newcomer to North America, but has taken off in the last few years, says Hartsman.

"Credit insurance is very popular in Europe. Probably 80 per cent of companies credit insure," he says. "Maybe 30 years ago it started here. It is not that old of a product in the U.S. and here, but growth has been double digit as of late."

Growth that was spurred by the recession of 2008.

WHAT IS TRADE-CREDIT INSURANCE?

Trade-credit insurance, also called accounts receivable insurance, provides your business with protection against the failure of your customer to pay trade debts. This can arise because your customer becomes insolvent or because your customer does not pay within the set timeframe. These risks are usually described as commercial risks. Companies that export can also protect themselves against a range of political risks that may prevent or delay payment. This arises when payment is not received as a direct result of a war in the buyer's country, cancellation of a contract by the government of the buyer's country, or when a government implements regulations which either prevent the export or import of the goods - or prevent or restrict the transfer of hard currency - from the buyer's country.

WHO USES TRADE-CREDIT INSURANCE?

Any business selling on open-account terms to other businesses can benefit from trade-credit insurance. From a practical standpoint, you generally need annual sales of $2 million to make the program cost effective.

WHY SHOULD I CONSIDER TRADE-CREDIT INSURANCE?

On average, 40 per cent of a company's assets are in the form of trade debts. Sometimes the figure is far higher. It is very difficult for a company to predict which client will default on payment. Close to 50 per cent of all payment defaults arise from vendors with whom stable and long-term trade relationships have been established. The cost to a business of non-payment can be considerable. For example, if a company's profit margin is 5 per cent and one of its customer defaults on a debt of $100,000, the company will have to achieve additional sales of $2 million to make up for the lost profits. More importantly, the lost cash flow could be devastating. Non-payment weakens your company and lowers its investment capacity. A trade-credit insurance policy helps in the management of your accounts receivables and compensates you in the event of non-payment.

WHAT ARE THE BENEFITS OF TRADE-CREDIT INSURANCE?

Cover is provided for investigation costs, defence costs for damages claims and OHS matters. Risks include breaches of D&O and/or fiduciary duties, trust, negligence, misleading or deceptive conduct and omissions.

- Better credit control and protection against catastrophic bad-debt losses.
- Better risk management through an early warning system bolstered by the insurance company database.
- Improved business planning through the elimination of unknown risks.
- Improved working capital from your lender because you have enhanced the quality of your accounts receivable with trade-credit insurance.
- Improved cash flow, because you receive payment for unpaid invoices that are insured.
- Mitigates concentration risk when large portions of a company's sales are concentrated among a few customers.
- Increase sales to new and existing customers.
- Helps establish new foreign markets to increase export sales.
- Reduce bad-debt reserves.
- More confidently achieve financial objectives.
- Provides cost-effective collection agency services.

"Especially when you go through a financial crisis – everybody is looking to protect their receivables. It has grown quite a bit from 2008," says Hartsman. "Once they take it, it is very rare that they ever drop it. It is like house insurance – when they get it, they want it forever, because they see the value of it."

One of the selling points of credit insurance is that it can be sold to just about everyone in every type of business.

"Every single industry pretty much credit insures," he says. "From jewellery – I even have a company that sells natural gas to the flower growers. I'm in the printing industry, in clothing; I'm in so many different industries. Every industry qualifies. Manufacturing is big, the computer industry, and companies that sell into retail are big."

One of the biggest names that keeps coming up for insurance is Walmart.

"Walmart is still one of the most asked about companies for insurance," says Hartsman. "Banks want the insurance on Walmart. For a lot of clients, 60 per cent of their business is Walmart."

Companies that have overseas clients should definitely look at credit insurance, he says.

"The beauty of credit insurance, you can be selling anywhere in the world, and you can be covered. If you are selling in China, you can be protected."

And for those who deal with overseas clients, pre-delivery insurance is a sound purchase, reimbursing the exporter for production expenses, due to his inability to supply the goods agreed by contract because of non-commercial risks, including the interruption of transport lines and/or certain commercial risks, such as the cancellation of contract and the bankruptcy of the buyer.

"It covers what POs (purchase orders) you have on hand that you were going to ship to them," says Hartsman. IB

Michael Hartsman
is the manager of Trade-credit at Firstbrook, Cassie & Anderson Insurance in Toronto, Ont.