

**LA GESTION DE RIESGOS POLITICOS Y FINANCIEROS EN
EL NEGOCIO EXPORTADOR**

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Sr. D. Roger A. Coesemans

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2. RISK MANAGEMENT PROCESS

2.1. Identification/Measurement

First, the risk must be identified.

Trade receivables - the amounts owed to companies by their trade customers - represent a very important corporate asset. In monetary terms they often exceed the value of inventories and their value can be significant in relation to fixed plant and equipment; they may easily account for 25 % or more of total corporate assets. Yet how much time do risk management and insurance executives responsible for devising insurance programmes for corporate assets spend on the subject of insuring trade receivables ? An obvious question in export business is thus what is the financial strength of the buyer.

I suspect that everybody searches on the person or organisation they are selling to but what about the person you are buying from ?

Do you think about the political stability of the country of the person you are selling to? This can have a considerable effect, and we are not just thinking about a country running out of hard currency. You can suffer just easily from import/export embargoes and from the chaotic administration in the country of the buyer.

Another consideration is whether or not the contractual terms are reasonable, bearing in mind the country of the buyer.

It has been suggested to me many times that the best contract is the one with which both parties are happy. I would agree with that wholeheartedly. If one party has a contract heavily weighted in their favour, it will be a bad contract and there will be difficulties. I have never followed the principle that, if I am doing a deal the best thing that I can do is screw the opposition into the ground.

There are certain countries in the world where you have to accept given contractual conditions. As long as you recognize that this is a risk and can manage it, fine. But if you do not take it into account, then you are not applying the correct risk management process, i.e. identification of the risk.

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2.2. Avoidance/Reduction

The subject of avoidance and reduction of the risk in an export contract could take up a seminar of two days.

- * The classical example given is "the FOB trap".

Quite often one thinks that, if the contract is an FOB contract payable by means of an irrevocable letter of credit confirmed against bill of lading, no risks are involved.

The question that remains is : what is going to happen if the buyer refuses to provide the ship, how are you going to get your cash under your ILC ?

- * An extension of the FOB trap could be that you are paid against entry documents and a warehouse receipt document when the goods arrive at the other side. If you are contracting FOB, once you have put the goods on board, you have lost title to them, they are no longer yours. If you do not get the shipping documents what are you going to do.

- * This brings us to the issue of retention of title. What is going to happen if your buyer goes into receivership and your invoices remain unpaid ? In some European countries, title retention is well regulated. Are you aware of these regulations ? A typical example here is Germany : in case you foresee a retention of title clause in your contract, you will have - legally - precedence to other suppliers not having this clause in their contract.

- * The terms of payment of a contract might pose another problem. Let us take the example of a cash contract payable say against an irrevocable letter of credit on delivery to site. If the security is acceptable but the site is on Ivory Coast, about 300 km from the nearest port. The question is, are there actual roads going to the site ? In one case one found that there were no decent roads, the only way to get the goods on site was by helicopter.

- * In addition to the aforesaid, we would suggest that terms of payment be mentioned, - if possible in the language of the country of the buyer - on invoices, confirmation of order and delivery documents.

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- * Now, what will happen in case of non-payment ? What corrective action will be taken ?
It is amazing to see, in some instances, how suppliers all - of a sudden fall a-sleep when they are in need of getting the monies on their bank account.
- * Another area in risk reduction lies with the law of the contract, the law of arbitration and where arbitration is taking place.

Indeed, the law of contract and the law of arbitration can clash, and it is a golden rule that, if you can possibly do it, make the law of the contract and the law of arbitration the same. Here again, the detail has to be watched. We know of one exporter who thought he had been superbly correct in showing arbitration as International Chamber of Commerce, Zurich, under the laws of Switzerland. Unfortunately, he had not stated whether he was talking about Swiss Federal Law or Zurich Cantinal Law - and that was 18 months in the courts to decide which had precedence ! So, think of your law of contract, think of arbitration, try and marry the two up. That is not avoidance, but it does go a long way to reduction.

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2.3. Risk Finance

Risk finance is the final stage of risk management. The issue boils down to two questions : how much risk should the company retain and how much should it transfer to an insurer ?

All companies will purchase some insurance, but the amount will vary depending on the nature and the needs of each organisation.

For instance, how willing is the company to assume risk ? How much can it afford to assume ? Is the business prone to small, frequent and therefore predictable losses ? Or must it also prepare for a rare, but potentially catastrophic loss ?

The answers to these questions are crucial for they will help an organization determine the right balance between risk transfer and risk retention.

The goal of risk finance is to have enough funds available after any loss so that the organization can continue to function and maintain a reasonable level of earnings.

Attachment I gives some guidelines to determine self retention levels.

3. EXPORT RISK INSURANCE

Trade receivables are insurable. Trade credit insurance is an established class of business generating premiums of more than US\$3 billion worldwide. Trade credit insurance covers the non-payment of trade debt due to

- . commercial risks (customer insolvency and default)
- . political risks (currency inconvertibility and transfer delay, payment moratorium, war etc.).

With recession in many of the OECD countries and increasing political instability in many other parts of the world, the risk to this key asset has never been greater. Trade credit insurance not only provides the obvious benefit of risk transfer, but also supports and reinforces good trade credit practise and provides policyholders with valuable market information on their customers.

When it comes to insurance, the route to follow is typically to take advantage of established national schemes. Ranges of comprehensive and specific policies to cover both Credit and/or Political risk are generally available. The public systems give the exporter the closest thing he will ever find to one-stop shopping.

The restriction of the national schemes - high premiums, lack of cover, limits on foreign content, limitation on credit periods, whole turnover policies - led inevitably to private competition.

The still remaining question is : what can insurance offer ?

First one must distinguish between the type of risk and type of institution to approach;

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3.1. Credit Insurance

The insurance market for trade credit insurance is experiencing significant change. Traditionally the market was rigidly divided into export credit insurance and domestic credit insurance. Export credit insurance was exclusively in the hands of the government-backed agencies, and domestic credit insurance was handled by a small group of specialist domestic insurers.

Domestic credit insurers can apply their local techniques to underwriting export credit risks. The big opportunities lie, obviously, in OECD markets where exporters and credit agencies can rely on the same sorts of detailed information on buyers.

Companies such as the Nederlandse Credietverzekering Maatschappij (NCM) in Holland or the Compagnie Française d'Assurance pour le Commerce Extérieur (CoFACE), often referred to as official agencies, are credit insurers. They administer medium to long term and political risk business as agents for their respective governments.

Great Britain's Export Credit Guarantee Department (ECGD) has two roles : medium term foreign commercial credit and project business. The short term business has been privatised and is now handled by NCM International.

For straight private commercial credit insurance, Trade Indemnity (TI) is the market leader, both domestically and in export transactions.

In the Federal Republic of Germany, Hermes acts, like NCM as a commercial insurance company in its own right and the government's agent for other business. In addition, a company like Allgemeine Kredit, associated with the United Kingdom's TI, plays a major role in credit insurance.

Belgium's export credit insurance agency, Office National du Ducroire (OND) is in the middle of revamping many of its strategies.

They recently acquired 20% in the Belgian COBAC (75% owned by the French SFAC) and transferred all of their OECD business to COBAC. Other local credit insurers are NAMUR which is present in 7 European countries.

In Spain, insurance is provided by CESCE, majority owned by the state, but with other bank and insurance shareholders. Other players in the field are Credito y Caucion, MAPFRE, Franzas y Credity and AIG Europe.

New arrivals in the field include the Dutch Royal Insurance, the French/English Sun Alliance which, similarly to AIG Europe offer non-traditional credit insurance. This means that the insurer takes the insured's credit control for granted but provides a genuine sort of insurance based on unforeseen happening : Catastrophy Credit Insurance.

See also attachment II : Catastrophy Credit Insurance, a new approach.

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3.2. Political Risk Insurance

The Political Risk market had its origins in London as far back as 1968 and Lloyds of London had the market to themselves until the late seventies when the American International Group joined this area.

Because this market does not suffer from being a member of the Berne Union, it has the ability to be more flexible. For example, there are no rules for length of credit for goods. This market will also consider the insurance of barter and countertrade transactions.

However the Political Risk Insurance market is not a medicine for all ills, it too has its disadvantages. For example, it does not cover full war since there is an exclusion which precluded loss if there is a "five great powers" war (covered by the national schemes). Private market schemes are limited to a maximum period of two years.

Attachment III gives a more detailed description of the basic covers available.

Attachment IV gives a short description of the role of the Risk Manager in handling Political Risk.

4. EXPORT LOSS EXPOSURES : CONCLUSIONS

Recurring themes in the Risk Management advice columns include doing a thorough job of the homework, the early use of legal advisors to produce water-tight contracts, the inclusion of letter of credit or other banking techniques such as forfeiting and discounting.

Other methods include assessing individual and country risks through analysis, hedging on foreign exchange rates and the council of a learned and experienced consultant.

Nonetheless, even the best plans go awry when lightning strikes unexpectedly. Adequate insurance may be the only effective lightning rod.

Policies covering trade risks are increasing both in number and in scope, with the specialist insurance broker becoming more and more important in order to batten down the hatches before a storm blows up.

RISK FINANCE : SELF RETENTION LEVELS

One of the most perplexing problems facing risk managers when they go out to buy insurance is :

- * Determining how much risk to self-insure within the deductibles or self-insured retention provisions of the policies they buy.

Insurance becomes an economical way to treat risks and losses at the higher levels, where losses are too large to be comfortably absorbed in a single year by your company or would have serious impact on your balance sheet and profits.

Several guidelines are available which can help establish proper risk retention levels, or at least can help develop parameters :

- * the maximum retained loss for any one occurrence is sometimes expressed in terms of one per cent of average earnings before taxes.
- * the maximum loss retention level for any single loss can be put at one-tenth of one per cent of gross assets.
- * a reasonable per-loss risk assumption level can be calculated as one quarter of one per cent of shareholders' equity.
- * Maximum risk assumption for any one loss can be calculated at five cents per share of common stock.

CATASTROPHE CREDIT INSURANCE : A NEW APPROACH

The current economic climate in Europe dictates that in the competitive world only the strong survive - a fact which has led over the last years to the collapse of several well-known companies.

Often left behind in the wake of such crashes, however, are creditors whose own financial problems are naturally increased by such events.

When analyzing insurance covers, we can make a distinction between general covers, which are most likely to be administered by the risk manager of a major concern, and the covers which are sought by the financial controller or director. This latter group is concerned with the cash management and, in particular, the cash flow of a company. Therefore, any contingency which has an impact on that cash flow now is likely to cause great concern. This concern will naturally extend to general asset protection, but it is well worth considering the priorities perceived by financial controllers and directors in order to understand the emphasis on these financial insurances.

In practice the loss of a major physical asset of a business, such as a factory or manufacturing unit, may not have an immediate impact on cash flow, particularly if sufficient stocks are held in other locations or in the hands of agents or dealers. Contingency plans can be implemented and the immediate survival of the business is not necessarily in question. However, the loss of a major debtor is going to dry up the flow of funds needed for raw materials, payroll, other creditors, etc. and a typically high-g geared company may have very real problems in refinancing this short-fall. This does not mean that the insured is necessarily bankrupt as the assets could well be tied up in stock or work in progress. However these are of little value to the harassed financial controller who is being pestered for funds to keep both revenue and capital projects alive and it becomes easier to understand why there is so much demand for this type of protection.

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The actual losses which can give rise to these cash flow hiccups are frequently defined in credit and political risk insurance policies. Leaving aside the political risk field from this article, it takes little imagination to see why credit insurance should be so popular at this moment.

Credit insurance is very much a study of the practical workings of business and is dependant on all the factors affecting those businesses. In particular, credit insurers have concentrated on the analysis of an insured's individual credit exposures from which they have built an enviable data-base for further credit limit decisions. An inevitable progression has been to make greater use of this expensive data-base to the point at which the insurer develops a credit management role in addition to the insurance facility and this pattern has been repeated in many insurance companies throughout the world.

Major corporations, who have never previously purchased credit insurance, traditionally consider credit a self-insured risk and carry some form of bad debt reserve.

The catastrophe credit insurance cover can be regarded as a reinsurance of this traditionally self-insured bad debt reserve.

The concept is different from any existing credit insurance facility sine it offers credit insurance on a layered basis with a substantial aggregate deductible to provide catastrophe cover considerably in excess of the day to day credit risk.

They layer of cover is designed to provide protection against credit catastrophe but it is unrealistic to suppose that this should provide cover against the loss of all the receivables.

In other words, the cover provides an indemnity against a monetary amount of loss, arising in the policy year, which is recognised as a catastrophe level (whether arising from several small to medium losses or fewer, larger losses) and which would undoubtedly have a severe effect on the insured's cash flow.

The cover is underwritten on the basis of an assessment of the insured's ability to operate effective credit control procedures. This approach enables the insurers to capitalise on the increasing levels of expertise developed by professional credit managers who have themselves taken advantage of better worldwide communications to improve the standards of credit information available, instead of endorsing endless credit limits in respect of individually insured buyers, the policy responds to detailed credit control procedures which are themselves endorsed into the contract and which form the basis of any credit judgment made by the insured.

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This process vastly simplifies the bureaucracy associated with credit insurance and reflects the insured's detailed knowledge of particular markets. However, it clearly cannot operate where the insured is selling to customers about which he knows relatively little and where the control of the credit is weak. In these latter circumstances there is a very real need for the more conventional forms of credit insurance which provide a valuable service of advice on many individual businesses, and indeed in those circumstances the credit insurance underwriter becomes an integral part of the overall credit control procedures for the insured.

The catastrophe credit insurance concept requires a high degree of professionalism in all areas of cash flow management and it is questionable whether such a product could have survived 15 or even 10 years ago. However, business management techniques have progressed, if only as a matter of necessity in our present economical environment. At the same time, information gathering techniques have improved radically.

While it is true that levels of information vary throughout Europe, for a variety of reasons, it is neither realistic nor constructive to say that the quality of company and credit information reduces the closer one is to the Mediterranean. It is very really the case then it is unlikely that the banking system in Mediterranean countries could survive. The truth is that there is a different attitude to the available information which illustrates the highly subjective nature of credit assessment. There is no real possibility of reducing all assessment techniques to a matter of formula operated by a computer. Instead the insurers are looking to the individual credit controller's expertise which is based not only on information to hand but past experience within specific trades. Of course, this must always be combined with a realistic attitude towards the likelihood of payment rather than the more euphoric attitude adopted by many salesmen to whom the placement of an order is the final goal.

Summary

Catastrophe credit insurance is designed for the professional financial manager in the larger corporation, who needs simplicity of operation and freedom of action. It is not intended to be a "hand holding" exercise or a substitute for effective credit control, but an insurance against the truly unpredictable fortuity of a major customer becoming insolvent, or an embarrassing accumulation of smaller losses.

In short, this insurance caters for managers who find existing credit insurance neither completely suitable nor adequate and who can distinguish between foreseeable losses and unforeseeable "catastrophes" in terms of bad debt experience. It provides a very simple method of reducing the guesswork involved in incorporating bad-debt provisions into financial planning. As the essential elements of self-retained loss and premiums cost are fixed then financial planners know in advance the maximum effect of unforeseen bad-debt losses on profit performance.

POLITICAL RISK INSURANCE

INTRODUCTION

The term "political risk" has been defined in a variety of ways. In this summary, political risk is defined as those potential actions by a foreign government that could damage the assets of companies, partnerships, individuals or other business entities and are either arbitrary or discriminatory.

The purpose of this summary is to give a synopsis of the major Political Risk Insurance coverages presently available.

TYPES OF COVER AVAILABLE

1. Exchange transfer embargo and/or delays

Often, contracts with buyers based in a foreign country will be payable in the currency of the buyer's country. Foreign investors and contractors may be concerned that the host government or its exchange authority will prevent them from converting local currency into the investor's or contractor's domestic currency.

This coverage is designed to assure that earnings, capital, principal, interest and other eligible remittances such as payments under service agreement, can continue to be transferred into the domestic or other internationally negotiable currency.

This coverage does not include losses due to currency fluctuations or devaluations.

2. Import/export embargo insurance

The foreign government, or even the contractor's own government, may cancel or refuse to renew an import or export licence, preventing the contractor from fulfilling the terms of a contract.

This insurance covers the financial consequences if contractual commitments cannot be met owing to cancellation or limitation of import or export licences.

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3. Contract frustration and repudiation

A foreign buyer may unilaterally terminate a contract with an investor/contractor, even though the buyer has no right or cause to terminate the contract under its terms and conditions as a result of government measures or regulations.

These actions may result in substantial losses to a contractor who has made expenditures or planning, research and development and equipment and supplies acquisition.

The Contract Frustration and Repudiation coverage is designed to indemnify the assured on an ascertained net-loss basis for expenses, costs and commitments arising out of the cancellation or repudiation of a contract to supply specific goods and/or services to a buyer.

Usually, the insured percentage of loss is 90 to 100 % but can be reduced on request.

Important to know is that this type of cover also insures against the non-payment risk on public buyers, be it government ministries, official import organisations or others.

4. Unfair calling of bonds coverage

Contractors are eligible to bid provided they produce a bid guarantee. The winning contractor may be obliged to provide a performance guarantee. Also, the contractor may have negotiated an advance payment that will require guaranteeing. These guarantees normally take the form of on-demand letters of credit issued by a local bank. The guarantee can be called arbitrarily, the buyer does not have to give the bank any reason for its demand.

The Unfair Calling of Bonds coverage is designed to insure against drawdowns that are not justifiable owing to non-performance by the contractor. The policy usually provides for compensation of 90 to 100 % of the amount drawn down.

Under the terms of the policy - if the parties have a difference of opinion - the decision whether the bond was called fairly or unfairly will be decided by international arbitration. The decision is binding for both, insured and insurer.

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5. Expropriation, confiscation and nationalisation

The most formidable seizure of assets by a foreign government is sudden expropriation of all of a firm's tangible assets - plant, equipment, land or inventories - in that country. However, seizure of assets may be subtle and gradual, known as creeping expropriation.

Examples are discriminatory property taxes, forced employment of unqualified nationals, required wage increases and price freezes. Such actions can intimidate foreign-owner corporations into selling out to the host government or to corporations owned by nationals.

Confiscation is seizure of a part of a firm's assets; the host government may seize a particular piece of equipment or shipment of goods. Such actions may hinder operations but, usually, do not force the victim to halt his activities.

The Expropriation and Confiscation coverage is designed to indemnify loss (and sometimes partial or complete damage) caused by Expropriation, Confiscation, Appropriation, Requisition or Wilful Destruction arising out of the action of a foreign government and/or public or local authority to an assured's investment in a foreign country or countries.

Creeping Expropriation is generally not covered under this policy but can sometimes be considered at the outset on a case by case basis.

The Expropriation and Confiscation coverage can be extended to include Nationalisation of assets based in a foreign country as well as action which deprives the assured of the use or possession of his property by a foreign government. A specific form in this class is available to cover Contractor's Plant and Equipment.

Indemnification under the nationalisation extension amounts to 90 to maximum 100 % of the actual loss sustained. As a practical matter, Expropriation/Confiscation insurance is an agreed value coverage, since replacement is improbable after a loss.

6. Extortion, kidnap and ransom

Politically motivated violence against company, its executives, staff, suppliers or customers can be included in the Political Risk insurance.

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7. Products extortion and business interruption

Under this coverage, indemnification against payment of ransom following a threat and the cost of recall and destruction of contaminated products can be made available.

This coverage has recently been extended to include indemnification against the losses sustained because of destruction of products against which an extortion demand has been made and the resulting Business Interruption losses.

PREMIUM RATES

The premium rates for Political Risk insurance are mainly based on the following considerations :

- exact type of cover required;
- terms of payment;
- insured's experience with buyer;
- nature of goods;
- political and economical situation of the buyer's country.

In view of the above, it is virtually impossible to compose a premium tariff for ready use.

Each case must be carefully studied and the premium rate assessed accordingly.

CONCLUSION

- It may be assumed that political risk is associated exclusively with activities in less-developed foreign markets with histories of political instability. Iran, Nicaragua, El Salvador, Uganda, Chile, perhaps the People's Republic of China, and many others, are countries automatically identified with political risk. Limiting consideration of political risk to such countries is not justified. Risk may be more significant in developed countries because of the high, concentrated levels of investment.

The take-over by the French Government of major interests in member companies of important multinationals illustrates clearly that political risk insurance may be as important to investing and contracting in developed countries as they are in less developed countries.

- The above listing of the different types of cover available is certainly not restrictive.

POLITICAL RISK INSURANCE

The Risk Manager's Role

To the limited extent that insurance is available for political risks, the risk manager is entering the more difficult and risky area of analysis and risk control. Provided the analysis is based on a thorough review of the available sources - preferably supplemented by practical experience and an emphasis on the tentative character of the assessment - the risk manager may will find his views welcome and his role growing.

In this respect, political risk is no different from many other areas where risk management input may be highly desirable - such as safety, security and fraud control. It is very important that the risk manager recognizes the character and limitations of his or her own skills and becomes a full team member. There is a growing field of literature on risk analysis in engineering as well as political risk that is well worth study and critical review.

The risk manager who already has a practical risk role in the corporation covering site visits and working with local management is at a big advantage when it comes to handling political risk. There is no substitute for practical experience, even two or three visits can provide the basis for much better risk assessment.

Ultimately, the choice is yours - to stay in the relatively quiet and comfortable world of corporate insurance or to venture forth to the action and risks of practical risk management of political and other risks.