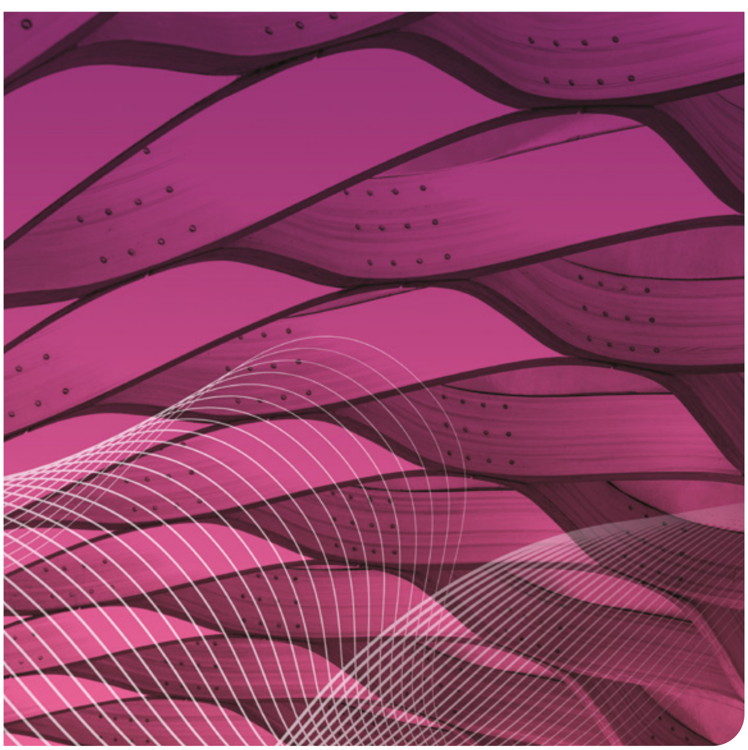


Trade Credit and Captive Insurance

As part of an overall risk management program, many companies purchase trade credit insurance as a way to protect it from the financial risk resulting from the bad debt losses in its accounts receivable portfolio. In companies with multinational operations, trade credit is traditionally used as one way to address concerns that companies may have with the concentration of receivables risk and with extending credit that is necessary to conduct cross-border transactions.

Artex | Alternative Risk

As the insurance marketplace becomes more challenging by the day, companies are again turning to captive insurance strategies as a way to create a more cost-effective risk management program for exposure to receivables risk.

Specific to trade credit insurance, a single-parent captive or a cell captive can be the foundation of an overall credit strategy to both plan for and mitigate catastrophic losses to the company, and to offer individual country business units advantages as well.

For example, an international company with multiple subsidiaries across the globe may choose to use a single-parent captive or a cell captive to retain the first layer of aggregate credit losses across the entire multicountry portfolio. The company and its captive work in partnership with a commercial trade credit insurer, which covers losses above the captive's retained layer up to the desired limits of liability.

Absent a captive insurance structure (e.g., purchasing a master large deductible policy), an individual local country subsidiary could be exposed to a large loss within its deductible, which could have a catastrophic and unacceptable effect on its local profit and loss results. The captive insurance strategy provides a platform for all participating subsidiaries to pay a predictable premium to the parent's captive to cover losses within the deductible, thereby transferring its P&L risk to the captive. When this risk is spread among multiple participating subsidiaries, the distribution of risk provides certainty for the operating units and creates a more stable risk pool for the captive. As a result, the captive structure provides both a financial and operational benefit to the local country subsidiaries.

BENEFITS OF A TRADE CREDIT CAPTIVE

- Allows for better accounting of the total cost of risk
- Creates a mechanism for operating units/subsidiaries to pay a predicable premium over time to reduce volatility of loss events and protect local balance sheets
- Creates a reduction in the company's overall total cost of risk and/or operating costs by simplifying administrative requirements and capturing underwriting profits
- Develops better leverage of insurers' policy management, centralized risk assessment, claims handling and reinsurance capabilities
- Offers direct access to reinsurance markets
- Provides a platform for self-insurance that satisfies local and global compliance requirements
- Provides a tool for more efficient distribution of receivables risk among subsidiary companies and allocation of premiums
- Provides greater control over the company's insurance program by unifying credit risk management across the business
- Allows broader trade credit coverage and/or the ability to insure otherwise uninsured/uninsurable risks
- Offers potential preferential tax treatment of allowance for doubtful accounts
- Provides for a diversification of the captive's risk portfolio by the commingling of risks that are not correlated for companies with existing captives for other lines of coverage, such as workers' compensation, property, etc.
- Offers greater negotiating power (with the traditional insurance markets) as part of an overall renewal strategy

HOW IT WORKS

Shown in the following diagram, the operating companies are now paying a premium to the captive, which is owned by the parent company or is a cell within a structure operated by Artex. This larger pool of participants smooths out the volatility that comes when each individual unit has their own deductible.

THE PROCESS

The first step in any captive insurance process is for the company to undertake a captive feasibility study to determine the expected financial outcomes of the program. This requires a determination by the company of the amount of risk that it is willing and able to take in the captive, and the retentions and limits desired or required to be purchased from a commercial insurer. When necessary, an actuarial analysis may be conducted for the potential captive's retained risk, based on the company's exposure and loss history. The study provides a qualitative and quantitative analysis for the parent company to use as the basis for making an informed decision on whether and how to proceed with the implementation of a captive insurance company.

COST, STRUCTURE AND TIME FRAME

There is a two-step process to assess the potential of a trade credit single-parent captive or cell and subsequent formation. Following is a sample, for reference only.

Part One

Time frame: 6–12 weeks; cost: $15,000–$45,000* (or equivalent local currency)

- Actuarial analysis of exposure and loss data if necessary, based upon the type of structure desired
- Analysis of the financial impact on the parent company and subsidiaries
- Forecast of captive's pro forma income, cash flow and balance sheet
- Forms the basis of the domicile-required business plan
- Review domiciles vs. corporate objectives and provide recommendation

*Actuarial analysis will increase the approximate cost incurred for part one.

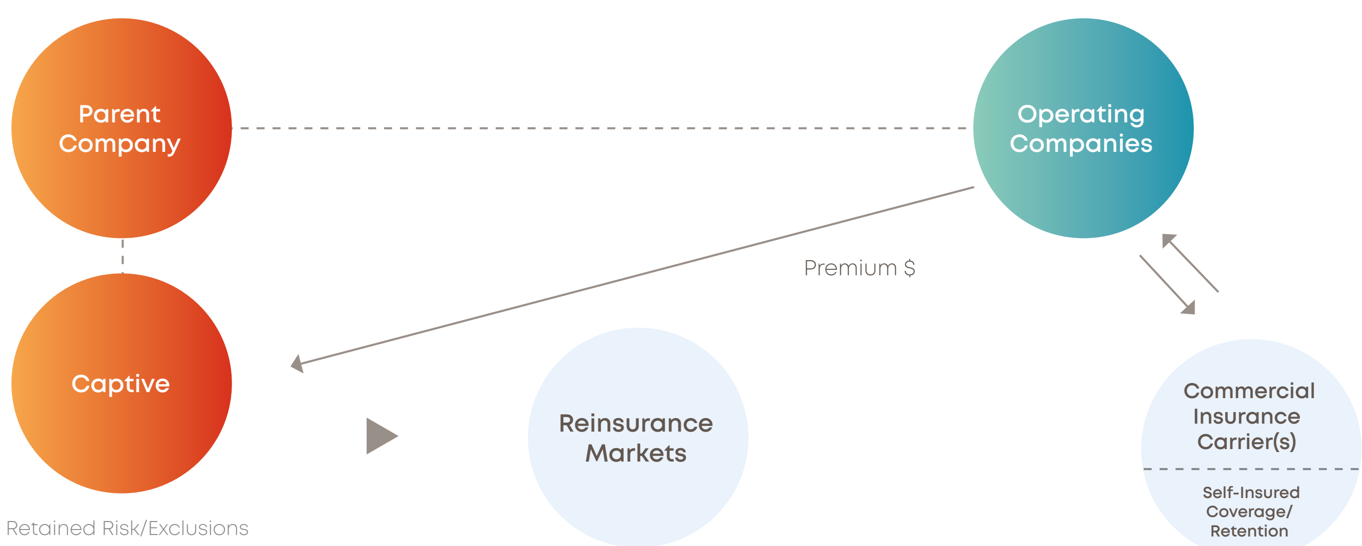
Part Two

Should the company decide to proceed with the formation of a captive, Artex will assist in the structuring and establishment of the captive in the domicile selected by the company.

Please note that the time frame is dependent upon a variety of items outside of our direct control, including regulatory requirements.

Time frame: 20–90 days; cost: $12,500–$30,000 (or equivalent local currency)

- Formulation of a business plan to provide to captive regulators
- Application for a captive insurance license
- Liaison with regulators
- Policy language, investment policy, etc.
- Compliance with requests for corporate information/ corporate governance



Matt is responsible for the production and project management of new business within the United States, and manages a team of account executives across the country. He started his insurance sales career at Hub International, and has spent the past decade at Artex helping grow the new business team.

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Matthew Atkinson
Senior Vice President, Business Development, Artex North America

Jeff leads our North American M&A strategy, and also plays a senior leadership role within producer education, sales strategy and complex sales. He has over 20 years of experience in the area of alternative risk financing, including work with captive insurance companies, segregated cell captive insurers, risk retention groups and self-insured trusts, with specific concentrations in healthcare, real estate and large multinational company-related risk.

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Jeffrey A. Kurz
Managing Director of Captive Insurance Sales and Consulting, Artex North America

Mike is responsible for the strategy, planning and delivery of growth for the international business. This role encompasses sales, marketing, product development and supporting client services. Mike began as a seasoned industry professional with over 30 years of experience in structuring and developing complex and innovative captive insurance solutions.

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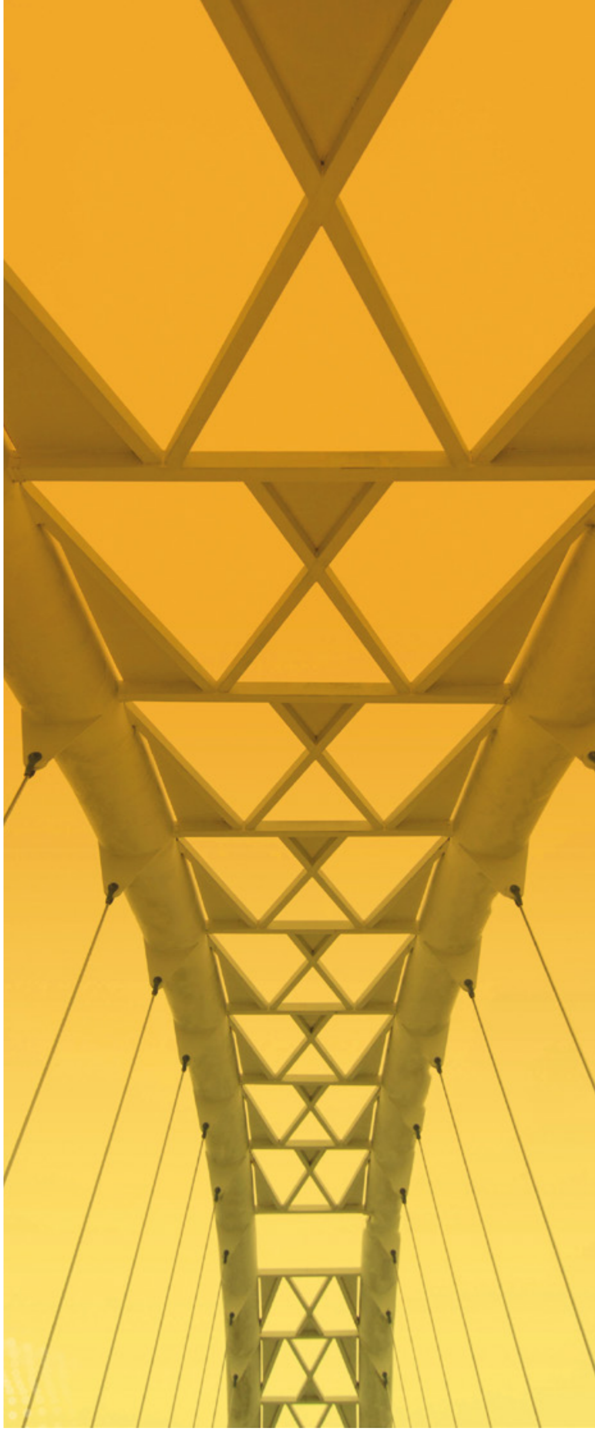
Mike Matthews
Commercial Director, Artex International

THE ART OF RISK

At Artex, we believe there is more to alternative risk management. As a trusted leader and provider of diverse (re)insurance and ILS solutions, our global team operates at the intersection of art and science—where creative thinking meets expertise and superior outcomes are made. That's how we're able to fully understand our clients' needs and deliver the most comprehensive solutions available.

Established in more than 35 domiciles internationally, we're here to help you make empowered decisions with confidence, reduce your total cost of risk and improve your return on capital. At Artex, we believe in finding you a better way.



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