



ENERGY INDUSTRY INSURANCE SOLUTIONS

ELECTRICITY PRICE & FORCED POWER OUTAGE COVERAGE
WEATHER DERIVATIVES
SYSTEM PERFORMANCE INSURANCE
TRADE CREDIT INSURANCE
ACCOUNTS RECEIVABLE PUTS –NON CANCELLABLE COVERAGE
MEDIUM TERM CREDIT INSURANCE
POLITICAL RISKS INSURANCE

Smyyth is a leading consultant and broker of specialized risk mitigation insurance products provided by global insurance and capital markets, including trade credit insurance, accounts receivable puts for non-cancellable coverage, medium term credit insurance, political risk, weather, and electrical outage coverage. The author is **Marc Wagman, Managing Director, Smyyth Trade Credit, mwagman@smyth.com**

There are a number of insurance products available to cover operational and credit risk in the Energy Industry. This brief summary provides highlights for finance and risk management executives.

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1. ELECTRICITY PRICE & FORCED POWER OUTAGE COVERAGE

Power generation outages, transmission constraints, fuel costs, and demand variances can cause price volatility and financial uncertainty. Forced power outages at a local or regional level can result in sizable losses both for producers and traders. Our products offer a unique double-trigger solution protection for both market price and volume fluctuation if:

- Unanticipated mandated rate reductions or generating unit outage
- Prevailing market prices exceed a predetermined strike price

Tailored to your requirements, this protection enables you to optimize the capacity sold under purchase agreements, and selling uncommitted capacity into the market when the price is advantageous, while limiting your financial exposure to a tolerable level.

- Flexibility with respect to structure, strike price, deductibles and limits.
- Provides an earnings and cash flow smoothing effect

- No requirement for physical damage
- Components can include heat rates, electricity prices or weather-related variables
- Eliminates the gap between start of an outage and business interruption insurance
- Provides implicit credit support for credit-limited participants

2. WEATHER DERIVATIVES

In many businesses, financial results are vulnerable to short and medium term weather variations, including, for example, retail, beverage, energy, construction, and tourism. Financial risk mitigation solutions can be written for:

- Single seasons or multiple years
- National or particular geographic regions
- Protection of suppliers, resellers or end users
- Implicit credit support for credit-limited participants at all levels of the supply chain
- Smoothing revenues and earnings, regardless of the weather trends
- Easing the pressure of inventory planning

3. SYSTEM PERFORMANCE INSURANCE (SPI)

Protects energy project owners, Engineering, Procurement and Construction (EPC) contractors, and technology vendors from specified technology performance risks.

Cost-efficient financing is the key to successful new projects, but lenders and investors are often concerned about the ultimate success of new technologies.

If the technology fails to produce the projected quantity and/or quality of output?

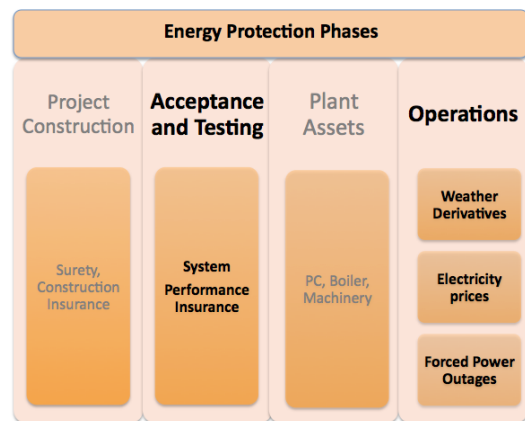
If the energy and/or power utilization significantly exceeds the level specified?

In the face of these concerns, project owners can take advantage of SPI as a way to obtain better financing terms from lenders and investors.

Important Advantages of SPI

With System Performance Insurance, alternative energy facilities may be able to:

- Reduce financing costs and increase amount borrowed
- Attract investors new to the industry
- Use lesser-known technologies
- Expand the pool of contractors



SPI is designed to help protect alternative energy projects against financial loss caused by a deficiency in the design of the technology that results in the underperformance of the project.

- Quantity – The system’s yield (e.g., gallons of ethanol per bushels of corn)
- Quality – The grade of output generated by the system
- Utility Consumption (steam, electricity, and natural gas)

SPI can be purchased by:

- **Project owners and investors** to insure their exposure to the technology design risk
- **Technology vendors and EPCs** to provide guarantees needed to bid successfully

System Performance Insurance runs from mechanical completion of the project through an agreed-upon performance testing period. The proceeds can be used to:

- Make system modifications to improve performance up to acceptable levels
- Pay contractual underperformance liquidated damages.
- Service the outstanding debt shortfall that resulted from underperformance.

4. TRADE CREDIT INSURANCE OVERVIEW

There are a number of insurance products available to cover commercial credit risk at the enterprise, customer and transaction level for many industries. This brief summary provides highlights for credit professionals as well as finance and risk management executives. Clients include domestic and international companies in all industries.

Credit Insurance is most typically known for coverage domestic and foreign sales, but as you will see below, there are forms suitable for overseas investment also, to minimize losses in case of sovereign default, expropriation, nationalization, contract frustration and political violence, to name but a few.

INSURANCE PROVIDERS

Credit insurance is provided by a number of specialized domestic and global insurance companies, including firms such as Chartis, ACE and Euler Hermes. Other forms of protection, such as Accounts Receivable Puts, are a type of derivative and are underwritten mostly by large Wall Street investment banks, including JPMorgan and Wells Fargo. We at Smyth work with all of these insurers and counterparties.

PROCESS AND COMPLEXITY

Credit insurance is a complex product requiring expertise that few conventional property & casualty insurance brokers have. An expert broker will guide you through the process, plus stay involved during the protection period to:

- Help client with preparation of the multiple applications
- Solicit proposals from the relevant insurers

- Compare pricing and contract terms and work with client to analyze the differences
- After the policy is in place, work closely with both client and insurer in the event of a claim for payment under the insurance or put contract.
- Negotiate the most favorable terms for new and renewing contracts.

There are three major policy types:

- Whole Turnover - insuring virtually all accounts
- Key Account - insuring only the largest customers
- Single Customer or Distressed Account

The benefits include:

- Protect your company from catastrophic credit losses
- Increase sales by offering your domestic customers
 - Higher credit limits
 - Longer terms of sale
- Open account sales to export markets
- Increased borrowing power when you have
 - Customer concentrations
 - Foreign receivables
 - Extended terms of sale

We can demonstrate for you how these programs are often self-funding, while increasing and protecting profits.

5. ACCOUNTS RECEIVABLE PUTS –NON-CANCELLABLE COVERAGE

This instrument is an effective way to cover your large credit exposure to a public or privately held company, particularly if that customer is in financial distress. This type of risk mitigation is used regularly by many companies of all sizes, from the Fortune 1000 down to mid-sized companies.

The Accounts Receivable Put Structure. You pay a fee that gives you the option of selling your receivable to a "counterparty", often a Wall Street investment bank, up to a specified amount, at an pre-established price, within an agreed timeframe, subject to a pre-determined event trigger, such as customer bankruptcy. This protection can be tailored to your requirements:

- Written to cover a single customer (obligor), even distressed and DIP credits
- Term from 6-60 months
- Protects up to 100% of the receivables amount; often no deductibles
- Amounts from \$500,000 up to \$100,000,000
- Non-cancellable coverage; coverage non-reducible

- Your customer is not notified that you have acquired protection

Other Important Features of Accounts Receivable Puts

- Accounts Receivable Puts are generally treated under GAAP as another form of insurance and as such are off-balance sheet and expensed.
- Accounts Receivable Puts can be also be used to cover supply-side Mark-to-Market Exposure. This means that the coverage can be structured to protect you in the event that your supplier's insolvency causes you to have problems fulfilling long-term contracts to your own customers under adverse market conditions.
- Accounts Receivable Puts are available on many public as well as large private companies.

6. MEDIUM TERM CREDIT INSURANCE

Medium Term Credit Insurance, provides financial institutions, exporters and infrastructure developers with private sector corporate payment default coverage for one to seven years. Underwriters typically extend this coverage in conjunction with a cross border financing of goods and/or other services. Coverage can also be procured for non-trade related finance, where the financing will be utilized for general corporate purposes or in a project finance transaction, provided that the underlying corporate obligor can satisfy underwriter capital to debt ratio requirements.

Typical policy coverage includes:

- Terms of 1 to 7 years;
- Capacity up to US \$100 million (with syndication) per transaction; and
- Flexibility to cover a wide variety of emerging market transactions.

Key benefits of coverage:

- Increases ability to take on credit exposure by relieving balance sheet constraints;
- Provides financial institutions with a more transparent alternative to loan syndication and credit default swap markets; and
- Enables insured to expand business with customers requiring additional credit.

Transactions might include:

- Bank loans and other debt issuances;
- Financing of deferred payment terms;
- Pre-export facilities; and
- Payment obligations under off-take contracts.

7. POLITICAL RISK INSURANCE

Political Risk Insurance can be used by financial institutions and investors alike on either a comprehensive or risk specific basis. Financial institutions can obtain comprehensive default coverage in conjunction with issuances or guarantees of debt to/by Sovereign government entities. Investors can comprehensively insure their equity ownership interests in infrastructure, commodities and other goods and services against a large variety of political risk events that may lead to the complete or partial deprivation of their interests.

Financial institutions and investors can also purchase political risk insurance on a more opportunistic basis, covering themselves against only those risks pertinent to their particular transaction. Coverage offerings include currency inconvertibility and expropriation of funds, expropriation of equity investment, political violence and arbitration award default. Whether you are a lender or investor, we can customize your insurance policy to maximize the coverage you need for your business. We offer extensive consultation services to determine the right coverage package for you. Political Risk Coverage includes:

Sovereign Non-Honoring Insurance provides financial institutions and other lending entities with Sovereign government debt and guaranty default coverage for 1 to 10 years. This default coverage can be obtained for a wide variety of transactions but typically in conjunction with specific government project mandates. Underwriters will also consider covering non-recourse/non-project related government financings provided that the relevant country's S&P and Moody's credit ratings meet minimal investment grade criteria.

Currency Inconvertibility and Expropriation of Funds Insurance provides coverage for 1 to 15 years against government measures that prohibit the otherwise legal conversion of profits, dividends, equity or trade receivables into the insured's currency denomination of choice. Coverage may also be procured for the expropriation or freezing of funds related to loans and investments made by an insured.

Expropriation of Equity Investment protects investors for 1 to 15 years against government acts that deprive ownership rights through either out right takings or, alternatively, piecemeal legislation referred to as "creeping expropriation". Additional expropriation coverages include: license restrictions and cancellation, forced withdrawal orders by home government, forced divestiture, and the implementation of trade restrictions by either the home or host government.

Political Violence covers lenders and investors for 1 to 15 years against risk of loss attributable to riot, activist groups and the acts of terrorist organizations that impair or completely destroy key operating assets.

Arbitration Award Default insures investors for to 1 to 15 years against the default of an arbitration award sanctioned by an agreement between the insured and relevant government entity.

Typical policy coverage includes:

- Terms of 1 to 15 years;
- Capacity up to U.S. \$100 million per transaction per underwriter and up to \$500 million if risk is syndicated out to market;
- Indemnity of 90-100%; and
- Flexibility to cover a wide variety of emerging market transactions.

Key benefits of coverage:

- Leverages insured's ability to assume foreign government credit exposure;
- Eliminates non-commercial investment risks;
- Enhances credit ratings of foreign government debt issuances; and
- Protects collateral security.

Transactions might include:

- Bank loans and other debt issuances;
- Energy and natural resource mining interests;
- A wide variety of emerging market infrastructure development projects; and
- Structured financial transactions.

Medium Term Credit Insurance and Political Risk Insurance are often combined in a solution to permit multi-nationals, exporters, financial institutions, commodity traders, fixed income securities investors and others to do business in emerging markets with greater assurance of a successful outcome.

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Prior to joining Smyth in 2003, Marc was Vice President for Euler Hermes ACI in New York. Earlier, he traded distressed accounts receivable and bank loans for Amroc Investments, a New York City based investment company. He began his career as a treasury and financial analyst for The CIT Group, Inc., where he co-managed CIT's interest rate swap portfolio. Marc graduated from Rutgers University with B.A. in Political Science, and obtained his MBA in Finance from the Fordham University Graduate School of Business. Marc Wagman at 201-714-4561 or email him at mwagman@smyyth.com to explore further.

