U.S. CUSTOMS BONDS

WHAT IS COLLATERAL AND WHY IS IT REQUIRED?

This document is for informational purposes only. A collateral statement and a General Indemnity Agreement must be signed in all situations where collateral is required.

WHAT IS COLLATERAL?

Collateral is an asset or assets posted to secure an obligation. When purchasing a Customs bond, a determination is sometimes made that collateral will be required. This determination is based on several factors that may include:

- The principal’s financial background and present financial condition
- The principal’s importing history
- The dollar limit of the surety bond
- The nature of the imported commodities (for example, commodities subject to an anti-dumping order)

How do underwriters determine if collateral will be necessary and if so, how much collateral will need to be posted?

The financial position of the importer is examined and an assessment is made regarding their ability to outlay funds and pay future duties, should a claim occur. Financial factors such as liquidity, profitability, positive cash flow and allowed net worth of the importer are reviewed. At the same time, the potential for, and likely severity of, claims are taken into consideration. All of these metrics are then entered into a risk calculator that mathematically determines the amount of collateral that will be required.

Why is collateral required?

The bond guarantees that an importer will meet certain financial obligations to the government. If the importer fails to meet those obligations, the surety will pay the government on the importer’s behalf and then immediately seek reimbursement from them. Collateral is required when we believe that the risk of loss under the bond and/or our potential inability to collect reimbursement from the importer are at greater than acceptable levels. One of the most common situations where collateral is required involves commodities subject to anti-dumping/countervailing duties. These cases generally remain open for many years and often result in the government seeking substantial additional duties from the importer upon liquidation.

What is considered acceptable collateral?

Collateral in the form of an Irrevocable Letter of Credit is the preferred way for an importer to demonstrate its ability and willingness to pay future liabilities under its bond(s). Letters of credit may offer importers better cash flow and preserves bank assets since a Letter of Credit may earn interest for the importer. A Letter of Credit may be obtained through the importer’s bank. The bank utilized must, however, be FDIC insured and approved by Avalon. We require banks to have a Highline Financial rating of at least 40 or higher. Ratings are on a scale of 99 (best) to 0, and assignment is based on objective financial statistics and comparisons to peer institutions. Many U.S. states also use the Highline Rating to decide whether or not to invest public funds in a particular institution.

When will collateral be returned?

A review of the surety’s collateral position will take place 90 days after liquidation of all entries on all Customs bonds to which the importer is a party. It is important to note that Customs can issue an increased duty bill for up to 90 days after liquidation (reliquidation of entries is covered in the Customs Regulations in 19 CFR 173.3).

Customs can also require payment of additional duties if it is determined that a “loss of revenue” occurred because of issues such as incorrect classification, improper utilization of trade preferences or that inaccurate values were claimed at the time of entry.

In some cases, the surety will determine that collateral for C1 and S1 Customs bonds can be returned 90 days after liquidation of all entries made under the bond. The surety can, however, be required to pay amounts on an importer’s behalf for up to five years after liquidation. If an importer obligates their Customs Bond for the Importer Security Filing (ISF, “10+2”), a six-year statute of limitations applies. For these reasons, the surety will reserve the right to determine when it is appropriate to return collateral on a case by case basis, based on historical information regarding the products, past claims history and importer’s financial background. Collateral will be returned when it is determined that all liability of the surety has been extinguished.

For other types of bonds, collateral will be returned when liability for undertakings made under the bond is no longer outstanding and there is no further risk to the surety. Two years after the bond termination date, the surety will review current financials, indemnity agreement and claims activity to make a determination whether full or partial collateral can be released. Please note that for ISF Appendix D Bonds, a six-year statute of limitations applies as mentioned above.

What does it mean when a letter of credit is “drawn down” and when would this occur?

A letter of credit can and will be “drawn down” for amounts for which the surety has incurred cost, loss or expense. With Customs bonds, this can happen when increased duty bills or liquidated damage cases are issued by Customs. If the importer fails to pay Customs, the surety will be required to pay on the importer’s behalf and will then “draw down” on the letter of credit. Letters of credit can be drawn down for non-payment of bond premium. Drawing down on a letter of credit is generally considered a last resort that is exercised when other efforts to receive payment from an importer have been exhausted. The surety may “draw down” on the letter of credit for the actual amounts paid to the Customs, any interest, all legal fees and any other fees or costs associated with the handling of the claim and any collection efforts that are subsequently required. A letter of credit can also be “drawn down” in instances where the liability under bonds or undertakings is still outstanding and the letter of credit will not be renewed or maintained.

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