An Introduction to Trade Credit Insurance

Business Information Factsheet

BIF465 · October 2016

Introduction

Many business proprietors provide credit to trade customers, enabling them to 'buy now and pay later', but then face the risk that those customers will not pay for the goods and services they have received. Trade credit insurance is a particular type of insurance that covers a business against bad debts or trade customers becoming insolvent. It is most commonly used when exporting goods abroad, but can also be used to cover transactions with customers within the UK.

This factsheet summarises the general principles of trade credit insurance and explains the types of policy available, the benefits of trade credit insurance, insurers' considerations when issuing a policy, and how to arrange trade credit insurance.

The principles of trade credit insurance and types of policy

Trade credit insurance covers a business against its customers failing to pay the debts they owe. It can cover bad debts or the insolvency of the customer, which are both categorised as commercial risks, and it can also cover political risks outside a business proprietor's control, such as those resulting from wars or natural disasters such as earthquakes.

There are different types of trade credit insurance policy available:

- A **whole turnover policy**, which covers all of a policyholder's transactions with their customers and enables the policyholder to grant customers credit up to a specific limit agreed with the insurer. The cost of the policy is based on a percentage of the policyholder's annual turnover, for example ranging from between 0.20% and 0.50% of turnover.
- A **specific account policy**, which provides cover for individual, named customers. The cost of the policy is usually based on the amount of money owed by these customers at particular intervals.

Trade credit insurance can be tailored to the specific needs of a business, for example in relation to the amount of the excess and the geographical scope of the policy, but it is often only provided to cover invoices that are due for payment within 12 months.

In general, trade credit insurance policies only cover between 75% and 95% of the policyholder's potential loss in order to ensure that the risk is shared between the insurer and the policyholder. Only debts that have been agreed with the insurer can be covered, and the policyholder must obtain the insurer's agreement if they intend to postpone the date that an insured debt is due to be paid.

Trade credit insurance specifically for exporters is available through UK Export Finance (UKEF), which is the operating name of the Export Credits Guarantee Department (ECGD), a ministerial department of the UK Government (www.gov.uk/government/organisations/uk-export-finance).

Go to www.gov.uk/government/publications/find-an-export-finance-adviser/what-are-the-implications-of-seeking-export-finance-adviser-assistance for more information about trade credit insurance provided via UKEF.

The benefits of trade credit insurance

Trade credit insurance can provide a number of benefits, as follows:

- Insurers can provide policyholders with useful commercial insights about their customers in relation to their financial status.
- Cash flow is protected as invoices are paid even if customers default on payment.
- Firms can expand with confidence, especially in new or foreign markets.
- 'Open account terms' can be offered whereby goods are delivered before payment is due, which is attractive to new customers and can help the policyholder's business to grow.
- Banks are more likely to agree to provide finance for firms that have trade credit insurance, and some even make it a loan condition.

Insurers' considerations when issuing a policy

Not all firms are eligible for trade credit insurance and it is not suitable for every type of business either. Insurers assess potential policyholders and their business processes when they make an application to buy insurance, and will expect them to demonstrate the following:

- That their trading terms are clearly defined and agreed with customers.
- That their customers are always required to complete formal credit application forms.
- That the policyholder has credit control procedures in place that meet certain minimum standards of efficiency.

The criteria that insurers consider when setting up trade credit insurance policies and charging rates for premiums include:

- The annual turnover of the policyholder's business.
- The sector in which the business trades.
- The financial status of the policyholder's customers.
- The length of time over which credit is given to customers.
- The policyholder's track record in relation to bad debt losses.
- How effective the policyholder's credit control system is.
- The size of each customer's account and the proportion of the policyholder's total turnover it equates to.

When reviewing a potential policyholder's business processes, insurers often recommend changes or improvements to their credit control systems, so that trade credit insurance can assist with credit management.

Arranging trade credit insurance

Trade credit insurance is usually arranged through insurance intermediaries or brokers who must be authorised and regulated by the Financial Conduct Authority (FCA).

The Association of British Insurers (ABI, www.abi.org.uk) and the British Insurance Brokers' Association (BIBA, www.biba.org.uk) provide details of their members.

Examples of insurers providing trade credit insurance include:

- QBE (www.qbeeurope.com/credit-lines/)
- AIG (www.aig.co.uk/business/products-and-services/trade-credit/trade-credit-insurance)
- Euler Hermes (www.eulerhermes.co.uk/credit-insurance/Pages/default.aspx)
- AON (www.aon.com/unitedkingdom/products-and-services/risk-services/trade-credit/trade-credit-insurance.jsp)

Hints and tips

- Insurers require potential policyholders to demonstrate that they have minimum standards of credit control and risk management in place, so it is important to follow best practice in pursuing overdue payments and to establish robust credit control procedures.
- Anyone seeking trade credit insurance should contact a broker for advice and 'shop around' for the best policy for their business.
- Be specific about exactly what cover is required, to avoid paying unnecessary premiums for cover that is unlikely to be used.
- Insurance policies should be updated if business circumstances change.

Further information

BIF 67 A Guide to Establishing a Trade Credit Policy
BIF 319 A Guide to Applying for a Consumer Credit Licence
BIF 422 An Introduction to Credit Control

Useful contacts

The British Insurance Brokers' Association (BIBA) represents insurance brokers and intermediaries. The BIBA website includes a jargon buster, insurance guides and a 'Find a Broker' directory.
Tel: 0344 770 0266
Website: www.biba.org.uk

The Financial Conduct Authority (FCA) regulates financial services in the UK, including insurance broker firms.
Tel: 0300 500 0597

Website: www.fca.org.uk

The Financial Ombudsman Service (FOS) is an independent body that deals with complaints between consumers and financial service providers, such as insurers and brokers.
Tel: 0800 023 4567
Website: www.financial-ombudsman.org.uk

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