British Insurance Brokers' Association

A guide to

Trade credit Insurance

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Contents

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1. Introduction

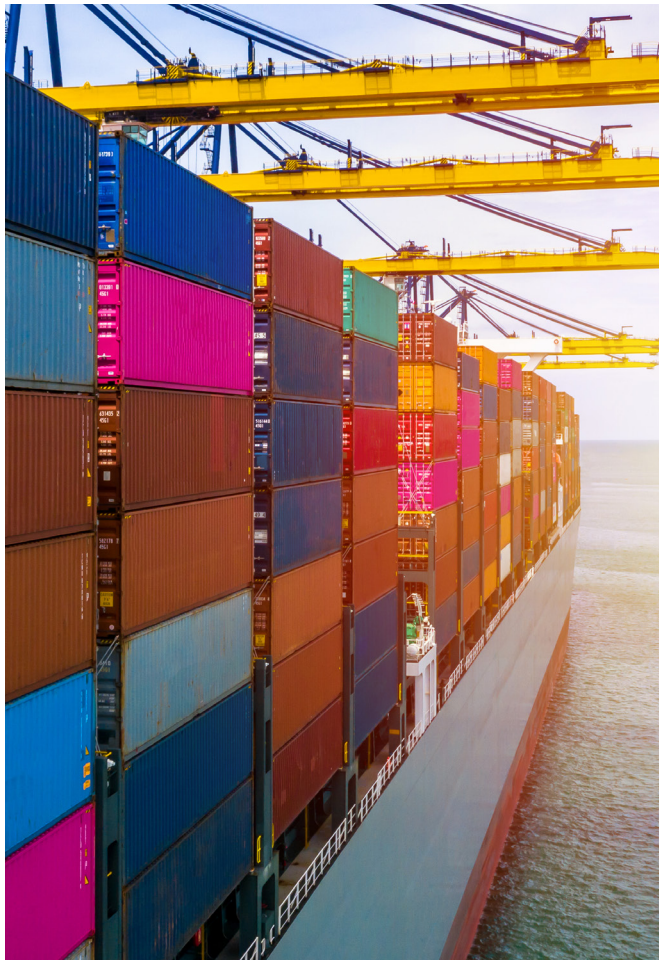
Trade credit insurance is used to protect a business' income if their customers fail to pay. As well as bad debt provision, firms may use trade credit insurance to leverage better borrowing terms from their own suppliers and lenders. Some may decide to pass this on as better credit terms to customers and achieve a competitive edge. Trade credit insurance can also be used in politically troubled regions, e.g. by overseas exporters.

Other terms for trade credit insurance are:

- Bad debt protection
- Bad debt insurance
- Debtor insurance
- Sales invoice insurance
- Debtor protection
- Sales invoice protection
- Credit insurance

This guide aims to help brokers understand the benefits of trade credit insurance for their clients, and the specialist cover and insurance terms used by providers.

Shaune Worrall, BIBA Technical Services Manager



"Trade credit insurance is an invaluable insurance product for business-to-business sales on credit terms. It protects the insured party by covering the risk of their customers not paying invoices through insolvency or buyer default. However, trade credit insurance does so much more than this. It is a tool to support a business' credit control procedures, improve cash-flow and ultimately aid business growth. The following guide will help you understand the importance and benefits of trade credit insurance." ***Stephen Uwins, CMR Insurance Services Scheme Director***

About CMRIS

CMR Insurance Services (part of PIB Group Limited) is the co-author of this guide and is the BIBA accredited scheme provider for trade credit insurance. CMRIS has been providing trade credit insurance for more than 30 years. Clients range from start-ups to major corporations in almost every key sector of business and industry.

2. Client features & benefits

2.1 Non-payment of sales

Trade credit insurance potentially reduces the risk of trading losses. It covers businesses against the risk of not being paid by a customer for goods or services it sells. Customers are referred to as buyers in the trade credit world.

The buyer might be your client's major customer, so trade credit insurance could be a cashflow lifeline if that buyer had financial difficulties or went bust.

A business can insure individual buyer debt, or its entire book debt.

This will involve allocating a credit limit to a buyer which has been pre-agreed with the insurer.

Businesses who use trade credit insurance are typically manufacturers and wholesalers, but any trade sector can obtain trade credit insurance.

2.2 Increasing a businesses' competitive edge

Trade credit insurance is about much more than bad debt provision. It allows some businesses to extend credit to new and existing buyers because more of their debt can be secured. This may help the business compete for new orders if they can offer better credit terms than their rivals.

2.3 Politically exposed 'buyers'

Cover is available as strategic protection against political risks that are beyond your client's control. This may be a lifesaver if a business trades in politically troubled countries.

This is a standard option for clients who export.

2.4 What your clients can hope to gain from trade credit insurance

• Protection – Fundamentally, trade credit insurance replaces money that is lost in the event of a bad debt.

• Peace of mind – Running a business is busy and stressful at times. Knowing that one of a firm's largest assets - its debtors - is protected can only reduce that stress.

• Efficiency – Trade credit insurers specialise in providing up-to-date information to help businesses make suitable credit decisions on their buyers, quickly.

• Funding – Trade credit insurance helps greater access to finance by improving a business' relationship with banks and lenders, which will know it is protected.

• Stay competitive – The ability to offer enhanced credit terms to buyers allows businesses to remain competitive.

• Growth, retention & profitability – Businesses can expand with enhanced credit lines for new clients' buyers while staying protected.

• Cash-flow – Trade credit insurance works with existing credit control procedures to reduce the average number of days that invoices remain outstanding before payments are collected.

• Confidence – Trade credit insurance encourages businesses to enter new markets including the export field.

2.5 Which of your clients might benefit from trade credit insurance?

Trade credit insurance is available to businesses of all sizes, from SMEs, to large corporates and international businesses, across any trade sector that supplies goods or services on credit terms to other businesses.

Points for brokers to consider

- A business can insure individual buyer debt, or its entire book debt.

- Trade credit insurance helps minimise the risk of an unexpected financial loss.

- Trade credit insurance may provide your client with an increased ability to compete for new business and at all stages of the business lifecycle.

- Trade credit insurance can help protect exporters when trading in volatile regions of the world.

- Trade credit insurance can help firms of every size whether they sell solely to customers in the UK, or abroad.

3. Policy cover

3.1 There are two main types of risk:

• **Commercial risk –** the risk that your client's buyers are unable to pay outstanding invoices for financial reasons, for example, **insolvency or protracted default.**

Typically firms may insure up to 90% of the debt, where they agree to a minimum retention.

• **Political risk –** non-payment as a result of events outside the firm's or buyer's control, e.g. political events (wars, revolutions); disasters, (earthquakes, hurricanes); or economic difficulties, such as a currency shortage that causes problems transferring money owed from one country to another.

Typically, firms may insure up to 95% of the debt.

3.2 Trade credit definitions:

• **Minimum retention** is a term used in trade credit insurance policies to describe a type of claim excess.

In the event of a claim, the insured firm retains the amount of the minimum retention or importantly, **the uninsured percentage of the debt***, whichever is the greater figure.*

• **Waiting period –** trade credit policies have a period of time after which, if invoices aren't settled, a claim is triggered.

The waiting period is agreed with the insurer at the outset, e.g. 3 or 6 months from the due date of the first invoice that is outstanding.

3.3 There are two main causes of loss:

• **Insolvency –** When a buyer is unable to raise enough cash to pay outstanding debts and other obligations the result might be administration, liquidation or a Company Voluntary Arrangement (CVA).

• **Protracted default –** When the buyer fails to pay for the goods or services within the waiting period detailed on the policy.

3.4 Whole turnover policies

Trade credit insurance is frequently based on a whole turnover policy.

Whole turnover policies protect against the risk of non-payment across the policyholder's entire debtor book.

The whole turnover policy will be structured to have a **maximum credit limit (MCL) per single buyer** and **insurers maximum liability (IML) per policy year.**

The MCL is the largest single credit limit allowed on the policy and the IML is the maximum (aggregated) claims allowed within the policy period.

There are two types of whole turnover policy premiums:

• **Fixed premium –** is based on estimated turnover which provides certainty of cover and price. The policy price is inclusive of risk premium, IPT, credit limit charges and VAT.

• **Variable premium –** in which the premium payable is based on the actual turnover achieved each month. Your clients will make a monthly declaration of turnover for the various countries they are trading with (be it UK only or worldwide) and are invoiced based on the risk rate e.g. pence for every £100 of turnover.

3.5 Single risk policies

Single risk policies are usually considered higher risk and premiums tend to be higher for this reason. They are underwritten on a case by case basis and can cover up to four buyers despite the policy name.

Underwriters will consider a number of factors before accepting the risk; the underwriter's assessment of the buyer considering factors such as the reasoning behind the request, for example a one-off contract for the business, and the percentage of overall turnover this contract represents.

Points for brokers to consider

- Trade credit insurance covers two main types of risk; commercial risk and political risk
- The two most common triggers for a claim are insolvency and protracted default
- Most policies have maximum limits of credit per buyer and maximum limits of aggregated claims per policy period
- Fixed annual premiums and variable 'declaration based' monthly premiums are available
- Either a whole turnover cover can be offered or a single risk policy.

4. Credit limits

A key feature of trade credit insurance is the assessment of credit worthiness of the buyer and continued monitoring throughout the policy period.

Credit limits are used as the basis of cover

4.1 How do insurers assess a buyer's creditworthiness?

- *Analysis of financial statements including management accounts*
- *Information supplied by their other policyholders that sell to the same buyer*
- *Public records*
- *Previous notification of overdue accounts*
- *Direct communication with the buyer (with your client's agreement)*

4.2 Setting credit limits

Your client can choose how to set credit limits by either requesting a credit limit decision from the underwriter or by establishing discretionary credit limit themselves.

Credit limit decision

Maximum credit limit basis - A buyer will be assessed by the insurer, and your client will be given a maximum insured credit limit for that 'buyer'. That is the amount the insurer will protect your client of that 'buyer' fails to pay, less any agreed minimum retention.

Discretionary credit limit basis - This covers a 'buyer' in the same way as a maximum credit limit basis except **the insurer doesn't formally assess the 'buyer'.** However, your client's insured credit limit will be restricted, typically to £10,000.

Since the insurer isn't assessing the 'buyer's' credit worthiness, there are two ways your client can establish a discretionary limit – credit reports and trading history.

Credit reports – your client can obtain their own credit reports on their buyer using a credit reference agency. They can set the discretionary limit up to the amount recommended by the referencing agency or the maximum discretionary limit stated on their policy, whichever is lower. Evidence of the credit report must be retained to use in the event of a claim. The report is valid for the period stated in the policy, normally 12 months.

Trading history – your client can establish a discretionary limit using trading experience. They should add up all payments they received from their buyer in the last 12 months that are paid within a **Maximum Extension Period (MEP).**

An **MEP** is the point an overdue account becomes notifiable to the insurer under the policy, usually 20 days.

Example

For example, if your client has a MEP of 45 days, the buyer must pay invoices before the expiry of payment terms plus 45 days. Any invoice that is not paid in this period would be excluded from the calculation of the discretionary limit based on trading history.

ABC Buyer Ltd:
Invoice 1 for £2,300 was on time (a discretionary limit of £2,300 can now be established),

Invoice 2 for £1,090 was paid 3 days after the Maximum Extension Period (MEP) (this cannot be added to their discretionary limit so it remains at £2,300)

Invoice 3 for £1,700 was on time (this can be added to their discretionary limit).

A discretionary limit of £4,000 could therefore established as the invoices 1 and 3 were paid on time.

N.B. A discretionary limit is only valid when using the same trading terms (or less favourable) in the calculation. For example, if in the last 12 months the policyholder had given their buyer terms of 30 days from date of invoice, the discretionary limit wouldn't be covered if they decided to give the buyer 60-day terms. [1]

[1] Examples based on the policy terms of one of the major trade credit insurers and can differ from provider to provider.

Points for brokers to consider

- Credit limits are the basis of cover
- Your clients can use the insurer's assessments for setting maximum credit limits or their own credit assessments based on credit referencing agency reports and/or trading history, to come to a discretionary credit limit
- Maximum extension periods are important as the basis for notifying the insurer of a claim

5. Ongoing help for your clients about the credit worthiness of their buyers

With a trade credit insurance policy, your client may be given extensive access to an information network that acts as an effective early warning sign for adverse buyer trends.

Unlike many other types of business insurance, the relationship between a trade credit insurance provider and the policyholder is not just active when a claim is made, it is dynamic through the life of the policy. The provider will support policyholders throughout the whole trading process, whether their buyers are in the UK or overseas.

During the lifetime of the policy, the credit worthiness of buyers is monitored by the insurance provider. They will warn policyholders if there is an issue with their buyer.

The information mitigates risk and can help keep the business profitable, so aiding growth.

Remember
Unlike other classes of insurance trade credit insurance is actively managed throughout the lifetime of the policy.

6. Premium calculation

Trade credit insurance premiums are calculated based on a number of factors:

- Company turnover
- Number of individual credit limits
- Loss history
- The level of liability required
- Buyer size

Further areas that could affect availability of cover might be the insurer's appetite and the general market conditions.

7. Accounting process and policy requirements

This illustration from CMR Insurance Services shows how a policyholder aligns their accounting and contract terms with a buyer to the requirements of the trade credit insurer's cover:

	1st March	30th March	1st April	30th April
Policyholder Accounting Process	Written order confirmation. Have you - the policyholder - applied for a credit limit?	Despatch date.	Send invoice.	Due date - encourage prompt payment of invoice.
Policy Requirements	Ensure your policy conditions comply with the terms of your contract. Check you have a credit limit in place.	Maximum period to raise your invoice is 30 days from the despatch date.	Send invoice. Please be explicit on the payment terms required. Ensure your invoice is within the maximum credit terms shown in your policy schedule.	Communication is key. Keep the insurer informed of any questions or concerned.

CMR INSURANCE SERVICES
Effective Protection Against Bad Debt

It's worth remembering that a trade credit insurance policy is an active insurance policy where the policyholder and credit insurance provider work closely together after inception. This allows for:

• **Proactive monitoring** - It's particular to trade credit insurance that the terms of cover may change over the lifetime of the policy to reflect the financial strength of an individual buyer. The insurer proactively monitors the policyholder's buyers, to ensure their continued creditworthiness, using the sources mentioned above.

• **Increasing cover limits** - During the policy period, a policyholder may request additional cover for any of its buyers. The credit insurer will then evaluate the risk of increasing cover and either approve or decline the additional credit limit request, with a clear and timely explanation.

• **New business** – A policyholder can request additional credit limits for new buyers at any time under an existing policy.

• **Withdrawal of cover** - If a buyer's credit worthiness changes significantly insurers may withdraw coverage. The policyholder benefits from the information that a buyer is no longer creditworthy.

Points for brokers to consider

- Trade credit insurance provides 'active' policies. Cover and terms can vary as the credit worthiness of the buyer changes

- There is continuous constant contact with the insurance provider and sometimes cover is withdrawn but this can be a warning to policyholders that the buyer is a poor credit risk

8. The role of credit control

A trade credit insurance policy stipulates that certain credit control processes must be followed by the policyholder:

Notifying overdue accounts

A key requirement is notifying an overdue account if the Maximum Extension Period (MEP) in the policy has been reached (section 4.) If you recall, the MEP is added to the due date of the first invoice that is overdue. It is at this point that there could be a potential claim.

Recovery action

For example, if the policy states a MEP of 45 days and an invoice is due on 31 March, this must be notified to the insurer if payment is not received by 15 May.

During the MEP many trade credit insurers will offer to take over debt recovery action to reduce the possibility of a claim materialising, and the cost of debt recovery is often covered under the policy.

Typically, policies may give cover where the debt recovery costs are £100 or more.

9. Claims

An example of communication between the insurance provider and the policyholder.

1st May

Maximum Extension Period (MEP) begins. (Check your policy schedule for details of your MEP). If a PH is not paid or becomes aware of any adverse information concerning their buyer, notify the insurance provider.

14th June

Expiry of MEP. If new shipments/invoices are not covered. PH need to ensure they have notified the insurer of the probability of a loss.

4th July

Deadline for the notice of non-payment. (20 days after the expiry of MEP). This is the latest point at which PH must notify their insurer of the non-payment.

30th April

Deadline for submission of a claim for protracted default.

31st October

6 months from due date of 30th April. This is the earliest the insurer can pay the PH claim under protracted default. This is called the date of loss.

9.1 What policyholders need to do in the event of a claim

The most common claim is an insolvency claim. Cash flow issues that could result in a protracted default claim often accumulate leading the way to an insolvency before the default claim date is reached.

N.B. A protracted default claim occurs when the buyer fails to pay for the goods or services within the waiting period detailed on the policy.

• **Protracted default (bad debt) claims** - In the event of a bad debt, your client is advised to start the claims procedure straight away.

• **Insolvency claims** - If your client is notified of a buyer's insolvency, they should send the insurance provider any information they have received, including information from an insolvency practitioner.

9.2 Notification

This usually starts with a letter explaining what has happened and a proof of debt form, which will need to be completed to confirm how much your client is owed.

Your clients will need to collate and sent information to their insurer which typically includes:

• Copy orders

• Copy invoices

• Evidence of delivery/service

• Current statement of account

• Trading history - to make sure the policy hasn't been breached

• Evidence of discretionary limit (if applicable) – a copy of a credit report from the last 12 months or trading history to substantiate cover

• Terms & conditions of the sale

• Insolvency paperwork

• Proof of debt form / Letter to lodge debt

• Confirmation of debt form completed by the insolvency practitioner

• Confirmation the policyholder as a supplier is ranked as a creditor

• Written confirmation of the ROT (Retention of Title) position (if applicable)

The ROT allows a business to transfer possession of goods which have not been paid for while retaining legal ownership of the goods until the buyer has paid for the goods.

9.3 Claims support

Plenty of information is needed to support a claim and this is where an experienced trade credit provider becomes invaluable to brokers and their clients. They can guide both the policyholder and their insurance broker through the process, step by step, and submit claims for them. This speeds up the process meaning a claim can be paid efficiently. The trade credit provider will continue to monitor the claim and deal with any queries that may arise. A benefit of the BIBA member Trade Credit scheme is that CMRIS can deal with the entire process on their behalf.

Points to consider
A trade credit provider is invaluable to both brokers and their clients in guiding them through the claims process.

Specialist brokers may be of assistance throughout the process which is an added benefit of the BIBA trade credit scheme.

9.4 Claims handling procedure (Using CMRIS as an example)

The policyholder supplies goods to the buyer on 30 day credit terms.

The buyer begins to struggle and gets into financial difficulties with increasing bad debts and cash flow issues.

As the policyholder had a CMRIS trade credit insurance policy, they were made aware of the financial difficulties the buyer was in, as cover was withdrawn.

The buyer files for insolvency as they are unable to pay money owed, including suppliers that sold on credit terms.

The policyholder is able to claim on its trade credit insurance policy for goods supplied before cover was withdrawn.

The claim paid allowed the policyholder to continue trading. The prevention of a significant bad debt has resulted in the financial survival of the policyholder. The claim payment could prevent cash flow issues further down the supply chain i.e. suppliers of the policyholder.

Points for brokers to consider

- A policyholder's credit control has an important early warning role to notify insurers about overdue accounts and assist with recovery action.
- The assistance of a specialist trade credit insurance provider to assemble claims information and manage the claims process could be invaluable to brokers and their clients.

10. Key credit insurance terms

Buyers – These are the customers of the policyholder. The term buyer is used in the sector instead of client or customer.

Company Voluntary Arrangement (CVA) – an agreement entered into voluntarily by a firm that pays creditors over a fixed period where the firm continues trading.

Credit limit – The amount approved for each buyer that the insured can trade with and still be covered. The limit can be revised during the policy period should the insured need a larger limit. Likewise, should there be a negative downturn the limit could be reduced or withdrawn, highlighting that there may be an issue with the insured buyer.

Insolvency – When a business is no longer able to raise enough cash to meet its obligations, or to pay outstanding debts as they become due for payment.

Insurer's maximum liability (IML) – The maximum amount the insurer will be liable to pay per insurance year.

Maximum credit limit (MCL) – The maximum credit limit decision on any one buyer shall be no more than the amount shown on the policy schedule.

Maximum extension period (MEP) – The point an overdue account on a buyer becomes notifiable to the insurer, usually 20 days. The policyholder then has 20 days to inform the insurer, at which point cover will be suspended for that buyer.

Open account terms – A sale where goods or services are shipped or provided before payment is due.

Political risk – Non-payment as a result of events outside the policyholder's or buyers' control, due to political events (wars, revolutions); disasters, (earthquakes, hurricanes); or economic difficulties, such as a currency shortage that causes problems transferring money owed from one country to another.

Protracted default – This is when a buyer fails to pay for the goods or services within the waiting period detailed on the policy. The waiting period is normally six months from the due date of the first invoice that is outstanding.

Retention of title clauses – These can allow a business to transfer possession of goods which have not been paid for whilst retaining legal ownership of the goods until the buyer has paid for the goods.

Threshold – This is set at a level that claims cannot be made if the overdue amount is less than the figure stated in the policy. If the overdue invoices are greater than the threshold then a claim will be paid less the uninsured percentage.

Waiting period - The time a policyholder waits after the due date of an invoice before a protracted default claim can be made.

Minimum retention – This is a type of excess that is found in trade credit insurance policies. In the event of a claim the insured retains the amount of the minimum retention or the uninsured percentage, whichever is the greater figure.

11. Frequently asked questions

Which type of claim is most frequent?

The most frequent claim type is an insolvency claim. Policyholders can make a claim as soon as a buyer enters any form of insolvency proceedings.

Are bad debts affecting SMEs?
More than 90% of registered UK businesses are SMEs so it is inevitable that bad debt is affecting them. A huge benefit of trade credit insurance is that it stops the domino effect which causes businesses further down the supply to be affected by a bad debt. An example would be sub-contractors suffering late or non-payment as the main contractor's buyer becomes insolvent.

How are premiums calculated?

The premium for a trade credit insurance policy is dependent on a few factors. The turnover of a business, the countries that a business trades into, the history of bad debt, the number of buyers insured and the trade sector. The minimum cost of a whole turnover policy is around £3,500. A single risk policy is normally priced higher and is underwritten very differently.

How can brokers help in the process?

Brokers can use trade credit insurance to help ensure their clients' ability to trade and even support their competitive position. As a trade credit insurance policy is an active policy, brokers might consider occasionally prompting trade credit clients to see if they have obtained cover on their buyers and to notify overdue accounts when necessary. A good trade credit insurance provider will work with the broker to the benefit of all parties involved.

What are the consideration for policyholders when their own terms of credit have been exceeded?
The point at which a debt becomes notifiable is when the Maximum Extension Period (MEP) is reached. Some insurance providers will offer policyholders an online system for notification of overdue accounts.

How does the insurer notify the broker that a buyer's credit worthiness has changed?

Any changes to buyer credit limits will be notified directly to the policyholder with their broker copied in if requested. For example, at CMRIS monthly reports are sent to brokers informing them of their clients' buyers' positions.

Can a policy be amended during a policy period?
Yes. Should a policyholder need a larger maximum credit limit (MCL), insurers' maximum liability (IML) or turnover in a new market/country, this can be added. Amendments may incur additional premium.

More information
For information, guidance or enquiries about Trade Credit Insurance contact CMR Insurance Services via:

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