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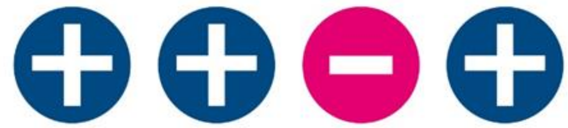

insurance services limited

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Financial and Credit Insurance Services Ltd

Credit Insurance Guide

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Introduction

What is Credit Insurance?

Credit insurance is purchased by businesses to protect themselves against the risk that a customer defaults on a payment obligation for the delivery of goods and/or services provided on credit terms. Non-payment can be due to the customer's insolvency, default or political causes.

The insured is the party purchasing the insurance policy who assumes the rights and obligations of the policy, the insurer is the company underwriting the risk of non-payment.

Trade credit insurance can be split into commercial risks and political risks. Commercial risks involve the insured's customers and their ability to pay for the delivery of goods and/or performance of a service to the insured. Commercial risks will usually include insolvency and protracted default of the customer. Political risks involve political events in the customer's country which give rise to a loss, such as war, embargos or other governmental restrictions on trade.

Who is Credit Insurance for?

Credit insurance is designed for businesses of all sizes, from SMEs to Multinationals, selling goods or services on credit terms to another business.

Credit Insurance Benefits

By purchasing a trade credit insurance policy, businesses are able to protect their debtor book and extend insured credits to their customers while reducing the risk of payment default. In addition, the following are further benefits of purchasing a trade credit insurance policy:

- Protects the company accounts, profit and cashflow against non-payment by paying the insured promptly for claims.
- Insurers offer risk management and have access to a wealth of information on buyers and industries to assist commercial decisions.
- Potential to gain competitive advantages including extended credit limits, higher credit limits, longer payment terms and expansion into new markets to enable businesses to grow.
- The ability to increase bank security and make borrowings and finance more accessible.
- Insurers have access to financial information, credit information and can offer advice regarding existing, new or potential customers.
- Credit insurance can be incorporated into a company's credit controls procedures to help businesses make informed decisions.
- The potential to decrease bad debt reserves and strengthen the balance sheet

Our role as your Broker

At Financial and Credit Insurance Services Ltd we are experts in credit insurance and understand how credit insurance can help your organisation flourish by protecting against the potentially disastrous effects of bad debt. As you credit insurance broker it is our role to:

- To act as your legally appointed agent, following obeying your instructions and acting in good faith with due care and skill.
- To establish your demands and needs with regards to your insurance requirement.
- To take due care and skill to ensure the suitability of our advice to you.
- To take due care and skill ensuring the insurance advised is suitable for your demands and needs.
- To conduct a fair analysis of the market in finding cover for your needs.

- To give you appropriate information to make an informed decision.
- To help manage the policy throughout its life in response to changes within your business.
- To act on your behalf with regards to claims handling and settlement.

Types of Credit Insurance Products

Wholeturnover

This is the most traditional and popular type of credit insurance policy which covers the entire business to business turnover of the insured company, which includes business transactions with current buyers and future buyers.

All customers which make up the insurable turnover must have a credit limit. Credit limits are established through the official approval process or under the discretionary limit.

Excess of Loss

Excess of Loss (XoL) policies are usually aimed at large or Multinational companies who have an established credit management team. They offer protection for large losses and usually have large discretionary limits which means less underwriting for the insurer and more freedom for the insured to use their own credit management procedures.

These policies can be “ground up” or have an aggregate first loss which the insured must accept prior to any claims being paid. There is usually scope for credit limits to be non-cancellable under an Excess of Loss policy.

Major Buyer

A policy offering cover for an insureds main or largest buyers. Cover is offered for buyers above a set exposure level. Underwriters must agree the credit limits.

Single Buyer

A policy offering cover for one buyer or one contract or a small selection of buyers.

Top Up Cover

Top-Up cover is available to increase the cover on a buyer where an insured is underinsured. The number of insurers offering these policies is limited and the premium rates are higher than the rates for other policies.

Non-Cancellable Cover

A policy where the credit limits are agreed and remain valid for the duration of the policy period and cannot be cancelled by the insurer. There may be conditions which allow deactivation of cover if certain events are triggered.

Credit Insurance Policies

Scope of Cover

Cause of Loss

The two main causes of loss covered by credit insurance are:

- Insolvency of a customer.
- Protracted default which is the failure by a customer to pay the contractual debt within a pre-defined period calculated from the due date or extended due date of the debt.

These are defined as commercial risks.

Political risks can also be included in the policy for exporters where cause of non-payment would be loss arising from political events in the customer's country.

Commencement of Cover

This is the time from which the insurer is bound to indemnify the insured. Credit risk coverage usually begins when goods are despatched.

Pre-risk/work in progress cover may also be included which provides cover for costs incurred before the despatch of goods. This coverage is appropriate for companies selling branded or bespoke goods.

Policy Duration

Policy durations are usually 12 months, however, longer term policies of 24 or 36 months are available.

The willingness of insurers to offer longer term policies will be dependent on the claims experience and prevailing market conditions. Longer term policies provide a longer term cost certainty to the insured but they usually include a condition which gives insurers the right to terminate the policy after year one if the claims are above a certain threshold.

Basis of Insurance

Credit Insurance policies are usually risks attaching or losses occurring. Risks attaching is a policy under which cover attaches based on shipment dates and where the shipment date (but not necessarily the loss) must occur during the policy period. Losses occurring is a policy under which cover is conditional on the date of the cause of loss occurring within the policy period.

Indemnity

Indemnity is the compensation for the loss. For commercial risks this is usually 90% and for political risks it is usually 95%. Some insurers will offer a lower indemnification percentage in exchange for a 'hands off' policy which requires little underwriting and where customers are covered without assessment of their financial soundness.

Excess/Deductible

The excess is the amount of loss that must be absorbed by the insured before indemnification under the policy. The excess is the contribution the insured is required to pay in the event of a claim before indemnification under the policy. There are a variety of excess and deductible types which are negotiable with most credit insurance contracts. These are explained below:

- Minimum Retention – the insured will retain the uninsured percentage if each insured loss or the "minimum retention" figure – whichever is the greatest value.
- Threshold – if the loss exceeds the threshold figure the insured can claim the full insured percentage of the whole insured loss.
- Non-Qualifying Loss – works in the same way as threshold but usually as part of a policy with an annual aggregate deductible / annual aggregate excess.
- Each & Every – the figure will be deducted from the insured loss and the insured will receive a percentage of the balance. (Some insurers deduct the Each & Every figure after the Insured percentage has been applied).

As your broker we can offer advice on these deductible structures and suggest which may be suitable for your business.

Maximum Liability

All credit insurance policies will have a maximum liability which is the maximum amount the insurer is liable to pay in respect of all claims during the policy period.

Loss Payee/Joint Insureds

The role that banks and financiers play in supporting businesses is recognised by credit insurers and policies can be structured to take account of this. The bank or financier can either be made the loss payee, meaning that they have first rights to any claim payment or they can be made a joint insured.

Retention of Title

For some policies, insurers may request Contracts of Sale to have a legally enforceable All Monies Retention of Title Clause.

Credit Insurance Policy Operation

Premium

Premium is set using the company's estimated insurable turnover for the policy period, taking account of the claims record. The premium will either be fixed or rated. Fixed premium is set for the policy duration and if estimated turnover is exceeded or less than planned the premium will not change unless the insurer views the change in risk as material. The premium may be paid in a series of instalments or one lump sum.

Rated premium applies a percentage rate to the estimated insurable turnover for the policy period which gives an estimated premium amount. The estimated premium amount is usually paid by deposit throughout the duration of the policy.

Throughout the policy or at the end of the policy period insurers will require a declaration of turnover to be made which will detail the actual insurable turnover. The premium rate is applied to the actual insurable turnover at the expiration of the policy and the actual premium amount is calculated. The sum of the premium deposits is compared to the actual premium calculation and a premium adjustment will be processed, either more premium will be due or a refund will be given. Insurers require a Minimum Premium on a rated premium policy meaning that if a refund is due the premium payable will not be lower than the Minimum Premium.

Credit Limits

Every insured buyer under the policy must have a credit limit in place before the insurer can be liable. Credit limits are established by either using the discretionary limit on the policy or through a

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This is intended as a guide and does not take precedence over any of the insurer's policy, policy schedule, policy wordings or other documentation supplied by the insurer.

formal application to the insurer. The credit limit amount must be high enough to cover the maximum exposure excluding VAT at any point in time.

A discretionary limit is usually offered on the policy which allows the insured to set a credit limit for their customers without formal approval from the insurer. The requirements to establish a credit limit within the discretionary limit without approval varies by insurer but usually the insured can use a credit status report or 6/12 months trading experience as justification.

Any credit limit required with an amount higher than the discretionary limit must be requested by formal application to the insurer. Most insurers have an on-line system for applications and you will need to gather information on the customer you require the credit limit on. In some situations, insurers may ask for assistance in gaining access to the financial accounts of a buyer to help make a decision on the buyer. The insured then receives a notification about whether the credit limit has been fully approved, partially approved or declined and any conditions of the credit limit.

Adverse Information

A credit insurance policy will require the insured (via their broker) to notify the insurer of any adverse information regarding one of their insured buyers. Adverse information will include events or circumstances that have led or may lead to a deterioration in the financial situation or creditworthiness of a buyer or a country of a buyer.

Overdue Accounts

A credit insurance policy will require the insured (via their broker) to inform the insurer of overdue accounts which occur in the duration of the policy. The policy document will specify how overdue the account needs to be before it is reported but it is usually 15 to 30 days after the Maximum Extension Period expires.

Maximum Extension Period

The policy document usually specifies a time period after the earliest due date for an account beyond which the insurer will not cover further deliveries or provision of services. This is known as the Maximum Extension Period.

Collection of Insured Debts

It will be a requirement under the terms of the policy for insured debts and non-payments to be promptly pursued.

Many insurers have a debt collection service which is either included in the cost of the policy or provided at discounted rate. If the insurer is providing this service then when the Maximum Extension Period expires the debt must be passed onto the insurer for them to pursue the collection.

Claims

To make a claim under the policy supporting information will need to be provided to the insurer within a set time period. A claim due to a customer insolvency will usually require a Confirmation of Debt from the Insolvency Practitioner appointed to the estate of the debtor company. For smaller claims insurers may have exceptions to this condition. As your broker we will support you in gathering the necessary information and submitting a claim where necessary.