YOUR GUIDE TO CREDIT INSURANCE
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INTRODUCTION

Welcome to Your Guide to Credit Insurance.
This Guide is primarily designed for those new to trade credit insurance however it may also be useful for buyers who have left the market for a period of time or indeed for companies that do not presently use the expertise of a specialist broker.

We hope that you will find this Guide useful!

Terry Kingston
Arthur J. Gallagher, Trade Credit Practice
CHAPTER 1

The Basics

The risk of customer non-payment is significant for many businesses. Trade credit insurance can provide valuable protection and has many other advantages.

In Chapter 1, we explain the basics of the product and why it should be strongly considered.

What is Credit Insurance?

Credit insurance is the protection against the risk of non-payment for the provision of goods and/or services supplied from one business to another on credit terms.

Non-payment usually arises when the customer becomes insolvent but can also arise because the business simply has insufficient funds to pay its debts, often referred to as “Protracted Default”.

Companies that export may well be faced with considerable additional uncertainty and risk. Exporters often therefore consider credit insurance invaluable in helping to make credit decisions on customers in unfamiliar countries, collecting overseas debts and of course providing protection in the event of non-payment. Exporters may be faced with the additional threat of non-payment as a consequence of political risks such as war, acts of overseas Governments, import/export restrictions, currency transfer restrictions and inconvertibility.

Exclusions:

Most credit insurance policies exclude
– sales to UK Government;
– VAT (or similar local taxes)
– sales to subsidiary and associate companies (although it may be possible to arrange cover against political risks)
– queried and disputed debts
Why is Credit Insurance so Important?

Debtors often account for 40% to 60% of a company’s Current Assets, and can be as high as 90% for a services company. It is however the asset over which a company has least control!

One of the most significant bad debt risks faced by a company is the domino effect. Companies often argue that they have dealt with their customers for years or that they do not feel there is any risk. The greatest risk is often that their customer will suffer a significant bad debt and will not survive as a consequence.

Who is Credit Insurance Suitable For?

Credit insurance may be suitable for any business selling goods or services on credit to other businesses.

Whilst credit insurance is widely viewed as a tool to protect the P&L and Balance Sheet against the effects of bad debts, it is also suitable for companies seeking a credit management solution that includes credit checking and collections, companies seeking to grow sales securely or those seeking support for finance.
CHAPTER 2

Benefits of Credit Insurance

All businesses have an insurance programme and yet often leave the debtor book unprotected despite debtors being the asset over which they probably have least control!

Here are some of the main advantages of trade credit insurance:

**Protects the company’s P&L and Balance Sheet against bad debt**
Cash is returned to the business promptly – insolvency claims are paid within 30 days normally.

**Potentially reduce and quantify bad debt provisions**
Credit insurance can reduce the bad debt provision significantly, strengthening the balance sheet.

**Facilitate/Improve finance**
Credit insurance is often used to provide security to banks and other types of lenders for trade or export finance.

**Increase profitability**
Fewer and protected bad debts, improved receivables management and focused marketing efforts using credit insurance have shown to increase profitability.

**Grow sales in confidence**
Credit insurance can help grow sales by enabling more competitive terms to be offered than would otherwise be acceptable and by providing the comfort to pursue new customers and to penetrate new countries or even diversify into new products.

**Prevent losses before they occur**
Credit insurers can assist by steering businesses away from bad risks in the first place and are often the first to become aware of companies in financial difficulties. Such information may assist in reducing exposure or at least ensuring it is not increased at the wrong moment!

**Maintain cash flow, profitability and protect budgets and business plans**
With a quantified cost attributed to the bad debt provision, plans can be made in confidence and achieved in the knowledge that an unforeseen bad debt will not upset the business’ financial position. Working to just a 5% profit margin, a business suffering a £50,000 bad debt would need to produce an additional £1m turnover to cover the loss at precisely the time when it’s difficult to do just that!

**Improve credit decisions**
Credit insurers are in the unique position of being able to gain up-to-date information that is not in the public domain. Accordingly, they are often significantly better informed than status agencies who are considered by many to be very liberal in their credit opinions as they are of course not taking any risk.

**Protect investors and stakeholders**
Helps fulfill corporate governance requirements.

“Cash is returned to the business promptly”
CHAPTER 3

Let’s Look at a Policy

Whilst there are an ever growing number of products available, most credit insurance policies work on very similar principles of operation.

Specific details will unavoidably vary however we provide below an overview of the common features and administrative requirements.

Examining the Scope of Cover

Causes of Loss
Credit insurance policies typically cover:

• buyer Insolvency; and
• “Protracted Default” which is the buyer’s failure to pay an undisputed amount owing within a predetermined period of time (this varies from insurer to insurer and may also be longer for certain export countries).

For exporters, many insurers also offer cover against Political Risks such as war, acts of overseas Governments, import/export restrictions, currency transfer restrictions and inconvertibility.

Commencement of Cover – Do I need cover for Work-in-Progress?
‘Credit Risk Cover’ traditionally commences upon despatch of goods.

Companies selling branded or bespoke goods may wish to consider extending cover to ‘work-in-progress’ (also referred to as ‘pre-credit risk cover’) which provides cover for costs incurred prior to despatch of goods.

Cover is in respect of Insolvency only although maybe extended to Political Risks, where appropriate.

Policy Duration
Policies are typically 12 months in duration.

Longer term arrangements - usually 2 years - are however often available. The availability of longer term arrangements will usually depend upon bad debt/claims experience and also general market conditions.

For many, 2 year contracts offer certainty of cost (although most Insurers attach a right to terminate the contract after the first year if claims have exceeded a predetermined percentage of premium at that point) however there may be potential disadvantages too. Consult a specialist broker to help you assess what is right for you.
Risks Attaching or Losses Arising?
Most credit insurance policies are issued on a ‘risks attaching’ basis meaning they cover risks that commence during the Period of Cover.

‘Losses Arising’ policies conversely cover losses that arise during the Period of Cover and tend to be restricted to XoL type structures.

Indemnity
90% indemnity is relatively typical.

Higher indemnities are available for very good risks and Excess of Loss (XoL) structures.

Deductible
The amount and style of deductible is largely down to choice (except perhaps following a period of bad debts when the insurer may need the security of a larger deductible) and will influence the premium significantly.

For most companies the styles of deductible include ‘Threshold’, ‘Each & Every’ and ‘Minimum Retention’ – these are explained and compared on Page 7.

Companies willing to accept a larger risk share, usually for a reduced premium, may wish to consider an ‘Aggregate First Loss’ whereby a predetermined value of insured losses in any single policy year are borne before claims will be paid.

A good specialist broker will help analyse and provide advice on the effects of different deductible structures to assist in making an informed decision which may also be affected by the company’s tolerance and attitude to risk.

Maximum Liability
Every insurer will state the maximum amount they will pay out in claims in any one period.

This is known as the Maximum Liability or Insurers Maximum Liability (“IML”).

Other Considerations
Retention of Title
Some insurers insist upon Contracts of Sale incorporating a legally effective and enforceable All Monies Retention of Title Clause, where appropriate. Assistance in clause design is available where appropriate.

Assigning the Policy
All insurers are able to recognise the interest of banks and other financial institutions. This may be done in a number of ways from simply allowing the recognised party first rights to any claim payments through to Joint Insured arrangements (depending upon the insurer).
Comparison of Different Deductibles

The following table shows the claim payment that would be due with each type of deductible assuming all else remains equal. For the purpose of these examples, an Insured Percentage (sometimes referred to as the Indemnity) of 90% has been assumed in all examples for comparison purposes.

<table>
<thead>
<tr>
<th>Value of loss (excluding VAT)</th>
<th>'Threshold' £1,000*</th>
<th>'Minimum Retention' £1,000**</th>
<th>'Each &amp; Every' £1,000***</th>
</tr>
</thead>
<tbody>
<tr>
<td>£500</td>
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<td>Not covered</td>
<td>Not covered</td>
</tr>
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<td>£25,000</td>
<td>£22,500</td>
<td>£22,500</td>
<td>£21,600</td>
</tr>
</tbody>
</table>

* Threshold
The Insured Debt must exceed the Threshold to be covered. The Insured Percentage then applies to the whole Insured Debt.

** Minimum Retention
You must retain either the Uninsured Percentage of the Insured Debt, or the Minimum Retention, whichever is the greater.

*** Each & Every Excess
You must retain both the Each & Every Excess and the Uninsured Percentage of the Insured Debt.

NOTE: Some Insurers deduct the Each & Every Excess and then apply the Insured Percentage whilst some Insurers apply the Insured Percentage first and then deduct the Each & Every Excess. The examples in the table above are based on the former basis.
How a Credit Insurance Policy Works

Premium

The premium may be fixed or adjustable. With ‘Fixed Premium’ policies, as the terminology suggests, the premium is fixed for the period of cover. If the budgeted insurable turnover is exceeded, there is no additional premium to pay; conversely there is no refund if insurable turnover is less than anticipated. The premium may be payable up-front or in instalments. The insurer may wish to charge an additional premium if there is a material or significant change to the risk or for underwriting new business that falls outside the scope of the original proposal.

‘Adjustable Premium’ policies incorporate a Premium Rate (there may be different Premium Rates applying to different markets) which is applied to the “insurable” turnover budget to arrive at an estimated premium spend. The estimated premium spend is usually then paid by way of deposits throughout the period of cover.

A Declaration of Turnover will be made periodically or at the end of the policy period detailing actual insurable turnover achieved – usually by country. Upon the expiry of the period of cover, the insurer will apply the premium rate(s) to the “insurable” turnover actually achieved to calculate the actual premium earned. The actual premium earned is compared to the sum of the premium paid on deposit; the premium is then adjusted with additional premium becoming payable or a premium refund due (subject to the insurer retaining any Minimum Premium specified).
Notifying the Insurer of Overdues/Adverse Information
All credit insurance policies require the insurer to be notified immediately of the receipt of adverse information regarding any insured customers.

The insurer must also be informed of overdue accounts occurring throughout the period of cover. Precisely how overdue the account needs to be before insurers wishes to be informed will vary but it is typically 14–30 days following the expiry of the MEP.

Collection Action
Insurers will require Insured Debts to be pursued promptly and progressively in cases of simple non-payment.

Many insurers offer collection services provided directly by them – which form an integral part of the policy – or by a partner. These are often at significantly discounted rates.

Where collection services are being provided directly by the insurer, the policy will require debts to be passed over for collection upon expiry of the Maximum Extension Period or earlier in the case of having received adverse information. The best course of action will ultimately depend upon the individual circumstances of the debt – a mutually agreed course of action will be taken thus protecting the potential relationship with the customer, where appropriate.

Claims
Claims must be supported with all relevant supporting documentation within a predetermined period of time following loss occurring.

Most insurers will require, in cases of insolvency claims, what is known as Confirmation of Debt from the Insolvency Practitioner appointed to the insolvent estate of the debtor company. Some insurers allow exceptions for smaller claims.

Credit Limits
A ‘sum insured’, or credit limit, must be established on each Insured Buyer, prior to the insurer’s liability commencing, either by using the discretionary limit facilities or by formal application to the insurer. The credit limit should be sufficient to cover the maximum exposure at any one time excluding VAT.

Most Insurers will offer a so-called Discretionary Limit as a means to setting credit limits up to a pre-determined level without referral to them. Justification for the amount of credit to be granted varies, however it is usual to be able to use status agency reports and/or trading experience – both are usually valid for 6 or 12 months depending upon the policy agreement.

Credit Limits, above the Discretionary Limit, are achieved by application to the Insurer. Most Insurers offer a web-based on-line system for this purpose.

Putting the Account ‘On Stop’
Insurers will normally stipulate in the policy a period of time following the earliest due date on any given account after which they will not cover further supplies or provision of services. This is often referred to as the Maximum Extension Period (“MEP”) or On-Stop Period.

Some insurers operate slightly differently and allow a period of time from the date of the earliest invoice.
CHAPTER 4

Trade Credit Insurance Products

In Chapter 4, we take a look at the main credit insurance products available.

Wholeturnover

“Wholeturnover” is the traditional form of cover and the most popular. Historically, the term derives from there being no adverse selection and the insured literally having to put forward the whole insurable turnover. The market has evolved greatly however over the last decade and Wholeturnover policies may be adapted significantly nowadays to fit individual needs including the ability to exclude sales to certain buyers, for example.

Such policies will normally incorporate a small deductible per claim although larger companies may opt for greater risk share as a means to reduce the premium. Indemnity levels can vary although 90% is typical.

Credit limits must be established on all customers with whom insurable business is undertaken. This is achieved either by application to the Insurer or within a so-called ‘discretionary limit’ which allows limits up to a certain predetermined figure to be set subject usually to a status report or satisfactory trading history.

All insurers offer web-based facilities to apply for credit limits and manage coverage.
Principal Customer (also known as “Major Buyer” or “Datum Line”)

As the name suggests, cover is focused on the company's largest buyers only. Cover is delivered on buyers with an exposure above a predetermined figure, known as the “Principal Customer Level” (or “Major Buyer Level”).

Credit limits are usually by agreement with Underwriters only. Once a customer is accepted for cover, the customer usually remains insured even if the balance outstanding falls below the agreed level.

A first loss may or may not apply. Indemnity levels can vary although 90% is typical.

Excess of Loss

Excess of Loss (XoL) structures are often the right solution for very large and multi-national companies seeking protection against exceptional losses. XoL policies are generally for companies with proven credit management.

Usually combined with high discretionary limits, the aim is for there to be less underwriting involvement giving the insured a significant amount of autonomy and freedom to operate within their own credit management procedures.

XoL policies will incorporate an ‘Aggregate First Loss’ requiring the insured to accept a predetermined value of insured losses in any single policy year before claims will be paid. Small debts will be excluded from the scope of the policy by means of a “Non-Qualifying Loss”.

XoL policies are often available with non-cancellable credit and country limits.

Single Buyer / Multi-Buyer

Cover may sometimes be arranged for a single buyer or a single contract.

Additionally, it is now possible to arrange cover for a selection of buyers – known as multi-buyer cover.

Top-Up Cover and Gap Fill Cover

“Top-up” and “Gap Fill” cover are both available to assist where an insured is underinsured or indeed uninsured, respectively, on a given customer with their current insurer.

There is a limited market providing these types of coverage and it may be necessary to seek the ‘primary’ insurer's agreement prior to arranging such policies.

Credit insurance policies have traditionally incorporated cancellable credit limits. This means that insurers continually monitor buyer risks and can reduce or cancel cover at any time.

Whilst this suits many companies and provides valuable intelligence and monitoring, several insurers now offer non-cancellable credit limits.
CHAPTER 5

The Role of the Broker

Engaging a specialist credit insurance broker is the cornerstone to finding the best deal and the right deal for you and furthermore to then securing day-to-day assistance to get the very most out of your policy.

A good specialist credit insurance broker will:

• Have access to all markets
• Help you identify and choose a structure that is suitable for your needs
• Report to you on the cost and structure of cover available as well as the credit limits available on your major customers
• Provide thorough and on-going product training
• Provide technical advice
• Understand your business to ensure that all receivables are adequately covered
• Provide on-going and regular assistance to maximise credit limit coverage including meeting with Risk Underwriters, as necessary
• Provide you with claims management facilities so that claims are negotiated quickly and diligently
• Conduct regular review meetings, as appropriate
• Keep you appraised of developments in the market
• Ensure that your needs are regularly reassessed and that the market is reviewed well in advance of each policy renewal ensuring that you continue to achieve the best and most appropriate programme of cover.
ABOUT ARTHUR J. GALLAGHER’S – TRADE CREDIT PRACTICE

Arthur J. Gallagher’s Trade Credit Practice is one of the largest specialist trade credit insurance brokers in the UK.

We arrange and service policies for smaller companies through to multinational organisations demanding innovative global solutions.

Whether your need is fairly straightforward or highly complex, Arthur J. Gallagher is an insurance broker whose knowledge, skill and expertise you can depend on.

We offer a comprehensive, thorough and passionate approach – we’ll help you find the product and insurer that’s right for you, explain to you the in’s and out’s of your policy, help to maximise your credit limit coverage, assist in getting your claims paid quickly and diligently and much more…

We understand that you can’t build a reputation on what you promise to do. We aim therefore to be good at what we do not just some of the time, but all of the time, and do it better than our competitors.

CONTACT US

For further information about trade credit insurance, or to talk to one of our specialists about how we may help your business, please contact us:

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