Briefing

BURGES SALMON

Insurance

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Trade Credit Insurance and when to use it

Trade Credit Insurance (TCI) is utilised to protect businesses from bad debt risk. As a specialist insurance product, the use of TCI as a debt management tool has increased markedly in the aftermath of the recession. Global economic volatility has alerted businesses to the need to control payment risks, both in their own and in other jurisdictions.

Bad debts de-stabilise cash flow, may lead to a business having to self-finance the debt, can undermine competitiveness and at its worst can cause a business to fail. The cost (both in time and financing) of pursuing a debt directly through the courts, has accelerated the development of TCI. Experienced brokers can provide important guidance as to the best and most competitive policy. This is important as increasing volumes of claims, largely attributable to failed credit arising from trading within Europe, has seen the cost of some TCI products increase.

What is TCI?

TCI is an insurance contract that passes the risk of a buyer defaulting on the payment of trade debts to the insurer. Cover is typically provided for debtor insolvency and protracted default (failure to pay within an agreed timescale). In some cases it can replace debt factoring and letters of credit as a tactical business option.

Why is TCI useful

TCI may be attractive to businesses because:

- It can avoid the need to pursue payment of a bad debt through the court system which can be costly, time consuming and cause its own pressure on cash flow. It is important to note that TCI may not avoid litigation entirely; insurers reserve the right to subrogate and may later seek to reclaim their outlay by pursuing a debtor through the courts.
- It can mitigate the negative knock-on impacts to a business of a bad debt.
- It can provide a creditor with the comfort of additional protection when doing business with less financially sound clients or within an economically exposed country, and can help to alleviate the concerns of shareholders stemming from this.

Types of TCI include:

Whole turnover cover

- Provides cover for any offers of credit to any client up to a certain amount (amounts in excess have to be agreed with the insurer)
- Insurers may exclude or limit cover for specific buyers which the insurer considers to be too high risk

Critical customer cover

- Provides cover against the default of named clients only – in practice these are clients that are critical to the insured's business

Specific risk cover

- Provides cover against a specific client defaulting or non-payment/failure of a specific transaction

Export trade credit insurance

- Export Insurance products can cover any (or a combination of) export credit risks including:
    - risk of non-payment (credit risk);
    - risks of a seller bearing the cost of producing bespoke products and then losing the deal to insolvency of the buyer or frustration of the contract (pre-delivery/work in progress risk);
    - risks of an unfair call of an on demand contract or bond (unfair bond/calling risk).

Exclusions

Although TCI policies are often bespoke, businesses may typically expect their TCI cover to exclude:

- Disputed debts: TCI is designed to cover undisputed debts. Often if a debt is disputed, insurers will wait for the outcome of that dispute before meeting a claim. This is the case even where the dispute is in another jurisdiction, which can be of significant cost to the insured.
- Intra-group debts: TCI policies will typically exclude debts owed to the insured by associated companies, such as companies within the insured's group.
- Damaged goods or non-delivery: as above, TCI is designed to cover undisputed debts. Typically TCI policies will not provide cover where payment for goods is withheld because goods have arrived damaged.

continued overleaf

- Debts due to political risks or terrorism: insureds should seek additional insurance to cover these risks.
- Debts owed by private individuals
- Debts owed by governments or government controlled entities
- Breach of law: especially for export credit insurance, cover may be excluded where an exporter insured fails to comply with any international legal importation authorisations.
- International sanctions/trade with identified countries: Some policies may exclude cover for trade with countries subject to international sanctions, for example Iran.

Political risks insurance

TCI can often sit alongside other products such as political risks insurance (PRI); PRI can be particularly useful where trading is within high risk politically exposed countries, and there is the potential for default to be caused by risks associated with this exposure e.g. political violence.

Practicalities

As with other bespoke insurance products, to ensure that the implementation of TCI is smooth, clients should:

- Use experienced brokers/legal teams
- Obtain clarity at an early stage as to what risks are covered, and if necessary take out supplemental insurance (such as PRI) to cover risks which are not
- Try and limit insurers' ability to cancel and to obtain multi-year cover (currently difficult)
- Provide insurers with full disclosure from the outset, ensure that credit control procedures are followed and that relevant personal are aware of the policy requirements for claims to be paid.

Experienced brokers and lawyers can provide invaluable input when obtaining TCI. Their advice can assist in getting the best cover at the best price and maximising the prospect that the cover can be relied on when it is needed.

Contact

Burges Salmon's core insurance group brings together insurance sector expertise in Financial Services Regulation, Corporate, Commercial and Dispute Resolution.

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