Trade Credit Insurance
An Old Product Renewed

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Recently, Euler Hermes forecasted an increase of 35% in corporate worldwide insolvencies for 2009, after an increase of more than 27% in 2008. With the continued economic downturn, organizations are increasingly inquiring about Trade Credit Insurance, sometimes referred to as Accounts Receivables Insurance. Lenders are quickly starting to require Trade Credit Insurance placements when using accounts receivables as collateral and organizations are scrambling to find coverage. And as the market for Trade Credit Insurance constricts, it is more important than ever to make sure you understand what a Trade Credit policy insures and how it works.

How is a Policy Utilized?

Trade Credit Insurance has been around since the end of the nineteenth century, most heavily used in Western Europe. It is a commercial insurance product that indemnifies a seller against losses from non-payment of a commercial trade debt. By purchasing a Trade Credit policy, the policyholder/seller and lender, can be confident that non-disputed accounts receivables will be collected by the debtor or the Insurance Company will pay within the terms and conditions of the policy.

The primary driver for its use has been in facilitating international trade due to the increase in risk when dealing with foreign laws, regulations, and communication issues associated with foreign revenue streams. However, today, this product is often used to protect accounts receivables while enhancing an organizations ability to offer open terms, provide aggressive credit limit values, and expand into the global marketplace.

Common reasons for Trade Credit Insurance placement include:

- Globalization - Entering new markets.
- Revenue Growth - Ability to aggressively offer credit terms without increased risk.
- Financing Terms - Lending institutions will often offer better financing terms when accounts receivables are insured.
- Bad Debt Reserve Reduction/Tax Deduction - When carrying high bad debt reserves, cash flow may be severely impacted restricted an organization ability to grow. Furthermore, Trade Credit Insurance premiums are tax deductible; however bad debt reserves are not.
- Insurance Against Customer Non-Payment - Insuring against this risk provides organizations the confidence needed to extend terms increase sales and profits.

How Does The Policy Work?

When placing a Trade Credit Insurance Policy it is important for the underwriter to have a thorough understanding of the organization. An organizations business strategy, financial health, and internal credit management expertise along with the organizations trade sector are essential to an underwriter's ability to place an effective program. The underwriter's goal is to not just indemnify losses, but assist an organization in reducing it's exposure to loss. The insurance company will have the resources available and have the risk analysts to better understand the credit exposures that an organization faces.

A Trade Credit Insurance Policy is not static; it evolves with an organization's changing needs. In some cases, particular significant accounts will be analyzed independently and limits written based on need/availability.

If an organizations client experiences financial difficulty the insurance company will notify its policyholders and develop an action plan to assist in recovery of outstanding receivables. If a loss should occur, the insurance company indemnifies the policy holder.

You may purchase coverage for all accounts receivables with a single limit, multiple limits, and even provide coverage for an individual sale, or an individual account.

Common Misconception

Trade Credit Insurance is often referred to as Accounts Receivables Insurance, and many organizations will confuse coverage with insurance provided under most organizations Commercial Property policy. The typical definition of coverage afforded on a Commercial Property Policy includes:

"Insurance against loss of sums owed to the insured by its customers that are uncollectible because of damage by an insured peril to accounts receivables records." -IRMI

The key here is the term "insured peril" and "accounts receivables records" meaning a loss, typically due to fire, explosion, or some form of property damage that occurs to the actual physical records. Consider for a moment that prior to the widespread use of computers many organizations used paper ledgers for their financial record keeping. In the event of a fire, these records would inevitably be destroyed, and the organization unable to recreate these valuable records. Hence, coverage would be afforded on an insured's commercial property policy. While this coverage is somewhat antiquated in today's world of co-location and daily record backup, the coverage still is offered on most Commercial Property policies.

Conclusion

As the economic downturn continues and businesses continue to consolidate, an organizations revenue streams are at increased risk. Furthermore, the constriction of credit availability and organizations' need to find new revenue streams globally, have dramatically increased the demand for Trade Credit Insurance/Accounts Receivables Insurance.

To assist, a Trade Credit policy provides a valuable extension of an organizations current credit department and allows confidence in future growth. Furthermore, a Trade Credit Policy can increase profitability by providing better terms from lending institutions, as well as enabling organizations the ability to extend terms to current and prospective clients. Financial executives can manage these risks more effectively by understanding and implementing a strong risk management program that utilizes a comprehensive Trade Credit Insurance policy and working with a knowledgeable insurance broker.