

### CREDIT MANAGEMENT INSURANCE

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Historically many businesses considered credit insurance as a luxury. Today companies are recognising how such insurance can offer invaluable protection – particularly in the current business environment. If a business fails to collect money from debtors on time (or at all), the following effects are likely to happen:

#### **a) Problems in cash flow**

A business may find it difficult to pay their own debts, purchase essential materials and even pay staff wages!

#### **b) Self-financing**

A business may have to finance the loss or late payment of a debt from their own turnover. This may mean a business with a high profit margin may have to increase their turnover significantly to make up for even the smallest amount of money.

#### **c) Reduced competitiveness**

A business suffering from bad debts may have no choice but to reduce the amount of credit they offer making them less competitive.

#### **d) Collection & legal costs**

If a business decides to take action to recover debts, this can often result in collection fees or solicitor fees. Alternatively, if the business decides to recover the debt themselves, the process can be timely.

Generally, if you offer credit terms to your customers you will increase your sales (the problem is you will also increase your bad debt). Is it an acceptable cost to insure those credit sales? Well, if you maintain the average annual company bad debt of 0.7%, and with the average annual insurance charge of 0.7% of turnover, the answer begins to sound obvious, 'yes'. Plus you will have the added benefit of extended cover across your debtors as a whole.

Credit insurance is designed to cover, usually for twelve months, a supplier of goods or a service from bad debt arising out of an act of insolvency (see Insolvency section) and some policies offer protracted default i.e. where they simply refuse to pay. All of your customers can be covered, or just your top customers (definitely not just your worst customers!)

Credit insurance premiums tend to cost between 0.3% - 0.7% of annual turnover (or turnover of your top customers if you only insure that part of your customer base) depending upon your previous bad-debt history and current debt management practices. The policy works by individual credit limits attributed to your customers. The limits are pre-set, and you can trade within the credit limit throughout the year without further reference to the insurer. You can request an increase in the credit limit.

Premiums may be paid in one payment but many insurers/brokers offer monthly payment, some interest free.

Many unforeseen and disruptive circumstances can appear in the world today. As we have seen of late, this is not confined to third world countries.

War, political unrest, military coup d'état, fraud, and all the problems any business in the world can suffer makes export sales without credit insurance: business suicide. Many suggest that your initial sales are covered, and evaluate at a later date when you have a high degree of trust.

#### **Types of Credit Insurance**

There are many types of credit insurance offered today, which are usually further tailored to the specific security needs of the business.

#### **a) Whole turnover cover (the most common solution)**

This comprehensive policy will cover the whole business. The policy allows the business to offer credit up to a certain amount: anything above this figure must be agreed in advance by the insurance company. The premium paid is based on the turnover of the business.

#### **b) Critical customer cover**

This policy allows a business to have insurance cover against a number of named customers (usually up to 10). Such customers may be under threat from insolvency, have a poor credit rating, or may be key customers. The business will be fully responsible for the remaining customers not covered by the insurance. The premium paid is based on the total outstanding debts of the named customers.

#### **c) Specific risk cover**

This policy allows a business to have insurance against a single customer or a large contract. The premium paid is based on the contract value or the turnover of the customer over the policy period.

#### **d) Export credit insurance**

If a business trades outside of the UK, this policy can offer insurance against non-payment of overseas customers. This type of policy can also insure against a number of risks including political issues, currency issues and dis-honoured letters of credit.

### **Frequently Asked Questions**

#### **What is credit (management) insurance?**

Protection for your business against non-payment by a debtor where goods or services supplied were not paid for upfront on delivery.

#### **What are the benefits of credit insurance?**

Credit insurance policies help out when your customer pays late (sometimes referred to as protracted default) or goes insolvent. The policy acts like a safety net protecting you from suffering financial loss because of your customer's failure to pay.

Further, many firms take advantage of the cover and increase their turnover where increased limits allow them to increase the level of credit available to certain customers. For example, where a firm previously set a £10,000 credit limit to protect itself and limited sales to this, a £20,000 limit would allow them to double their turnover for this client and avoid possible competition.

Actually being credit insured can have its advantages with banks and other credit providers (including suppliers) as your cash-flow tends to be protected. Further, by letting customers know that you have credit insurance, can influence those same customers to settle your invoices sooner - failure to do so will damage their own credit rating.

#### **What exactly does the insurance cover?**

Normally 85-90% of the insured debts – when the buyer of the goods/services becomes insolvent or does not pay on time.

#### **Can I be specific about what I want to insure?**

You can insure individual invoices or specific customers or your whole book of customers. Insuring selected invoices or customers has only recently become available.

#### **How much does it cost?**

Most credit insurance is sold on a whole turnover basis (whole book of debtors i.e. not including cash sales or local authority/government sales) and generally costs between 0.15% to 0.8% of a company's insurable turnover. Insuring selected invoices or customers generally starts at 0.4% of the insured amount. Many companies pass the cost of the insurance on to their customer.

**Can I get cash up-front? How does credit insurance compare with factoring or invoice discounting?**

No, you would need to talk to a factoring or invoice discounting company for cash up-front. In some cases, a credit insurance policy will make the debt easier to factor. Factoring is usually used to deal with short-term cash flow issues and credit insurance is used to provide you with "balance sheet" peace of mind.

**Can I take out a policy on a customer who is currently in Creditors Voluntary Administration?**

Generally, no. Credit Insurance policies usually protect you against companies that go insolvent during the policy period, not before the policy period.

**How Rowlands & Hames can assist you**

Speak to your usual Rowland & Hames Account Director for further information or a no obligation quotation.

**Please contact Rowlands & Hames for further information.**

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