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Wholesale & Specialty

What is Trade Credit Insurance?

Also known as Accounts Receivable Insurance, Trade Credit Insurance is commonly required by lenders in European countries. However, it had largely flew under the radar in U.S. markets until the financial crisis of 2008 revealed the vulnerability of many companies. Businesses began to seek new ways to protect themselves from sudden downturns in the economy. Enter Trade Credit Insurance. But what makes TCI so attractive? The answer lies in its simplicity. If your business extends a line of credit to another business and there is failure to pay, TCI covers the loss. U.S. corporate bankruptcies hit a 13-year high in 2023, and as economic volatility increases, business owners may consider this coverage as an additional layer of protection.[1]

There were 642 U.S. corporate bankruptcy filings in 2023, significantly above 2022 and 2021.[1]

HOW DOES TCI WORK?

When businesses engage in large transactions with other businesses for goods and services, payment terms are typically established. Often, there is no money received up front, resulting in unsecured debt for the company supplying the goods or service. The supplier is relying on the reputation and financial security of the companies they partner with, but transactions don't always go as expected. For example, let's say Company A extends a line of credit to Company B for $1 million of goods with net 90 payment terms. This means if the customer pays the invoice balance in full within 90 days, they pay no interest on the trade credit.[6] But unfortunately, 30 days later, Company B defaults and files bankruptcy. While Company A may be able to receive some compensation through the bankruptcy proceedings, it generally won't be anywhere close to the full $1 million owed. Without TCI, all Company A can do is write off the bad debt expense.[2]

Now, let's say Company A had TCI coverage. In that case, the insurance company would compensate Company A for the loss. The insurance company would then take responsibility for recovering the funds from Company B. This allows Company A to safely resume normal operations without a substantial hit to their revenue. For many businesses, shifting this $1 million liability can save years of financial hardship and potential bankruptcy.

SECONDARY BENEFITS OF TRADE CREDIT INSURANCE

Businesses that operate in the B2B space and issue payment terms (i.e. net 10, net 30, etc.) are the most likely candidates for Trade Credit Insurance. However, TCI can cover business in many other cases. TCI is also useful for companies that engage in international business. Often, evaluating the risk of foreign companies is difficult and cost prohibitive. It's also impossible to predict political disasters resulting in sanctions or embargoes. TCI can help protect a business in the event a foreign company is unable to pay.

The global TCI market was valued at approximately $9.2B in 2023 and is expected to become a $23.9B industry over the next decade.[4]

However, TCI can do much more than make a business whole. Many companies leverage TCI as a tool for expansion. If Company A wants to increase the lines of credit to Company B but finds the amount too risky, TCI can help mitigate the risk. It can also make a business more attractive to lenders. When a bank sees that a company's revenue sources are protected by TCI, it has more confidence that loaned funds will be repaid. TCI can also offer protection to a business seeking to penetrate new markets by assisting companies in managing operations and investments efficiently. As a key tool for developing a balanced cash flow management policy, TCI allows businesses to both enhance and protect commercial development while mitigating the risks trade credit can pose to the organization's cash flow.

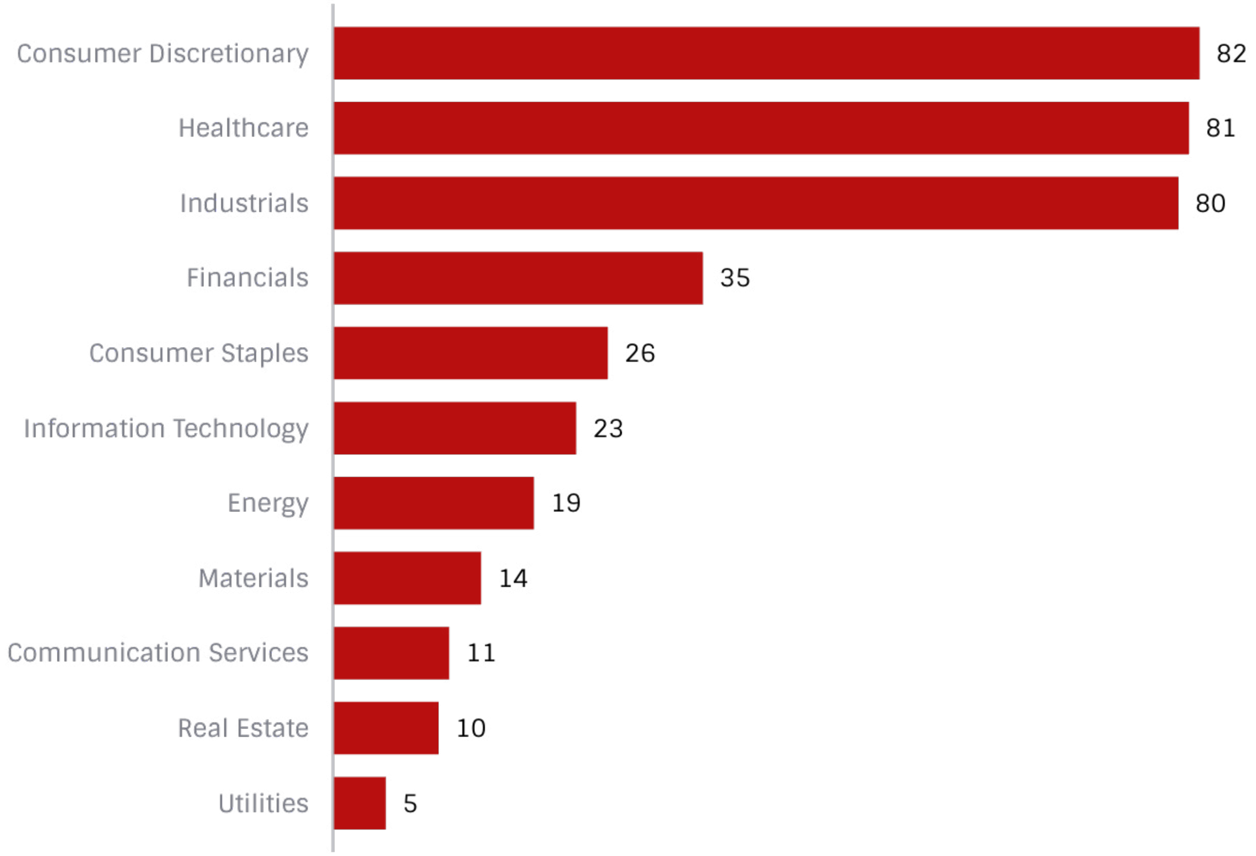
HOW TCI IS UNDERWRITTEN

How can TCI do all of this? It's all about the underwriting process. Simply put, the insurance company has access to much more information than the average business. When a business applies to insure their accounts receivable, the insurance company can pull a credit history, transaction history, and other public and private data for their business partners. Once a risk has been thoroughly assessed, credit limits can be determined, and the policy put into place. The company seeking coverage also benefits from an unbiased third party's assessment of their risk of exposure. For example, there is a documented case of an insurance company discovering an impending bankruptcy before the company itself knew they were at risk. In cases like these, the insurance company can warn the insured business to prevent damages from occurring in the first place.

COST AND LIMITING FACTORS

The cost of TCI coverage is generally reasonable. Premium typically hovers around .0025% of the annual coverage amount with 10% co-insurance and possible deductible (dependent on industry and risk). However, there are events that TCI does not cover. For instance, TCI does not cover a company's unwillingness to pay. If a company is refusing to pay as a result of a dispute, the insurance company will not pay the claim. Furthermore, if the insurance company discovers an agreement was made in bad faith, the claim will generally not be covered.[5] If a business extends a line of credit beyond the terms of the TCI, the insured assumes responsibility for any of those losses. Businesses in high-risk countries such as Russia and Iran will typically fall outside coverage. The cannabis industry is also generally excluded.

2023 U.S. BANKRUPTCY FILINGS BY SECTOR[1]



**S&P data complied 1/1/23 – 12/31/2023 for public and private companies with assets or liabilities at the time of bankruptcy of $2M or greater as well as private companies with assets or liabilities at the time of bankruptcy of $10M or more. Primary sector data not available for 256 of the 2023 bankruptcies filed.*

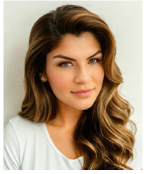
BOTTOM LINE

Market sophistication for TCI is growing every day and now is a great time to capitalize on its growth. Over the last 10 years, TCI has seen double digit growth year over year - and for good reason. While credit insurance is not a substitute for thoughtful credit management practices, it both supplements and enhances the credit professional's role.[4] TCI not only offers significant protection, it supports growth opportunities for companies that add it to their coverage portfolio. Whether a business is seeking to protect slim profit margins or expand new revenue lines, TCI can offer the peace of mind needed when dollar amounts rise. It's expected that as economic volatility grows, decision makers will become more receptive to this type of coverage. Reach out to your CRC Group producer today to learn more about how we can help your clients protect themselves in the face of economic uncertainty.

CONTRIBUTOR

Dan Lazarz is a Director with CRC Group's ExecPro Practice Group. He specializes in the effective placement of all lines of coverage within the Professional Liability, Management Liability, Healthcare, and Cyber & Data Privacy marketplace.

GUEST CONTRIBUTOR



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ABOUT ALLIANZ TRADE

Allianz Trade is an international insurance company that offers a range of services, including trade credit insurance, debt collection, surety bonds and guarantees, business fraud insurance and political risk protection. Learn more here.

END NOTES

1. US bankruptcies hit 13-year peak in 2023; 50 new filings in December; S&P Global Market Intelligence, January 9, 2024. https://www.spglobal.com/marketintelligence/en/news-insights/latest-news-headlines/us-bankruptcies-hit-13-year-peak-in-2023-50-new-filings-in-december-79967180
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