

COVID-19 impact on trade

The role of credit insurance

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COVID-19 leaves businesses urgently looking for ways to weather the pandemic storm

According to IMF figures published in [Aon's latest C Suite Series report on Credit Solutions](#), the global economy grew by just 3% during 2019, the lowest rate of growth since the recession of 2009, with further slowdown expected in 2020. This prediction, however, was made before the outbreak of COVID-19 which is now expected to push the global economy into recession. One direct consequence could be a reassessment of the use of credit insurance by companies urgently seeking ways to maintain revenue, protect their balance sheets from bad debt, while securing access to bank funding.

Already an economic and trade crisis

In 2019, we saw an increase in demand for credit and political risk insurance as companies looked to protect against payment default or to lower the cost of working capital finance. Early 2020 had already seen social unrest and political tensions rising with insolvency trends up and uncertainties growing. The world has now awoken to the realities of a global pandemic. It is difficult to see which sectors will be unaffected; while the Services industries can function with employees working remotely, many other sectors require staff to be physically present. According to credit insurer Euler Hermes, COVID-19 global business disruption could create a reduction in trade of goods and services of around USD320bn per quarter, with insolvencies to rise an expected 13% compared to 2019.

Airlines and tourism are expected to be primarily impacted by consumption downturn; and China, Italy and South Korea's economies have already been hard hit. However, the magnitude of COVID-19 related issues across industries and countries is still uncertain.

Wuhan, the centre of the outbreak, manufactures steel, including a huge range of components for the automotive and technology industry across the globe. In Europe and the US the automotive industry was fretting about international sales at the beginning of the year; these concerns have now been transposed to production lines. As COVID-19 leads to lockdowns across countries, we can expect to see further impacts across more sectors.

Supply chain as key risk factor

Inevitably, there will be a big reduction of the supply chain which will, in turn, cause a domino effect on the economic situation. If a company cannot produce because they suffer from a lack of supplies and materials then they will face significant operational and financial issues. Many companies are expected to experience a marked drop in turnover and revenue but, unless country governments intervene, they will likely still have to pay all their fixed costs such as employee wages and building/office rents. Large numbers of businesses operating on already tight margins do not have the balance sheets to handle a situation when they are not producing. The consequences for many could be insolvency.

Credit insurance reactions to immediate economic and trade downturn

If a global recession bites then we can expect increased bankruptcies, with companies and certain sectors such as Travel and Leisure, Automotive, Textiles, ICT and Retail expected to be particularly under threat.

The credit insurance market is expecting a significant increase in payment defaults and insurers have started to implement plans to review and reduce their insured exposures in certain countries (e.g. China and Italy) and trade sectors as highlighted above, particularly to reduce unutilised credit limit capacity to actual/current trading levels.

Clients should be able to rely on their broking advisor to implement a pro-active credit limit maintenance process in order to help ensure that their insurance programmes weather these turbulent times. This should also include periodic calls with the head offices of key credit insurers to pro-actively monitor the situation as well as create a platform for appealing critical limits.

Also importantly, insurers will need transparent and up-to-date information, especially around liquidity and cash flow forecasts, to continue to write credit limits on businesses. To ensure availability of coverage for their suppliers, businesses will need to share updated business and financial information with credit insurers in the same way they would with lenders.

From a loss settlement perspective, insured businesses should mainly consider that, unless advised otherwise, insurers expect that normal policy requirements apply. For instance, non-payment cases should be pursued and reported, in line with normal practice. Aon will issue a technical bulletin around claims and loss settlement shortly to help companies navigate these extraordinary times.

Reassuring lenders

Financing could also become an issue in the longer term as banks and financial institutions perceive some businesses as too vulnerable to lend to and hence become more selective. In the absence of specific government support to business there will inevitably be a liquidity crunch and the corporate bond markets will become difficult/expensive. [Aon's C Suite Series report](#) highlights how banks have looked to “de-risk their own balance sheets” which has had a knock-on effect for businesses of being unable to secure credit. COVID-19 will only heighten that sense of banking caution and they will be looking for additional security when lending money, which is where credit insurance can play a larger role in terms of insuring a business's trade receivables, thus giving a bank more confidence.

Although the COVID-19 pandemic will ultimately come to a close and global trade is expected to resume at some point in the future, its economic hangover is likely to be longer-lasting. The positive news is that the credit insurance market has learned from previous financial crisis. Insurers now have access to better financial transparency on the credit risks covered with the data and analytics that they didn't possess ten years ago.

For more insights around Credits Solutions that support businesses , download a copy of Aon's latest [C-Suite Series report](#).

For more information around overall pandemic response, access [Aon's COVID-19 Response Site](#).

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