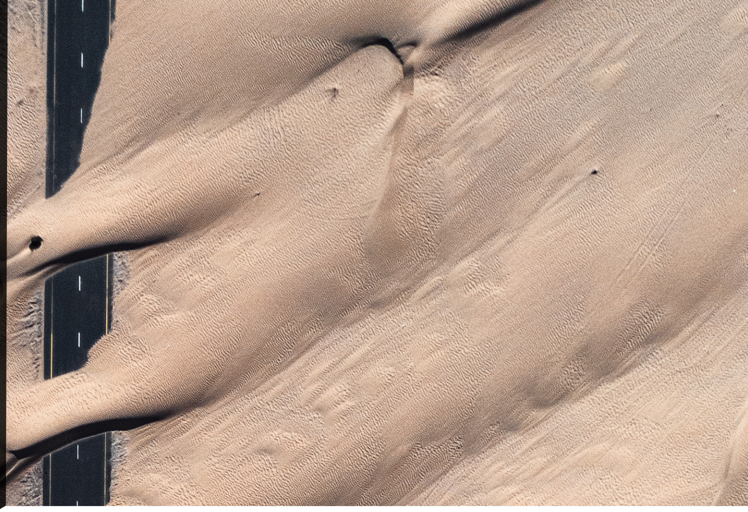
C-SUITE SERIES

CREDIT SOLUTIONS



Credit insurance in a global recession

Composure and long-term thinking

27 April 2020

As COVID-19 spreads globally, economic forecasts deteriorate and the importance of credit insurance increases.

While organisations continue to deal with the COVID-19 global health emergency and the short-term implications, thoughts are inevitably turning to focus on the longer-term impact. For many businesses, liquidity, trade and getting supply chains moving will be at the top of their priorities once the peak of the crisis starts to recede. And the role that the credit insurance industry can play in facilitating those objectives will be critical.

The challenge, however, is that at the very time businesses need the products and innovation offered by insurers, capacity will inevitably be tightening in response to the deteriorating economic conditions. Flybe, Hin Leong Trading, Agritrade International and Virgin Australia are recent examples of corporate defaults impacting multi-billions of dollars of creditors.

Given the volume of global trade underwritten by credit insurers (USD 3 trillion+, source: ICISA), their role in getting supply chains flowing will be imperative which is why we are starting to see governments providing capital support to the industry (Germany and France being recent examples).

The economic and market volatility we see today will eventually stabilise and credit insurance will remain important for trade. Our view is that the present situation demands a reflection point for both insurers and clients to think long-term in their provision and use of credit insurance solutions.

More than just cover for bad debt

Aon's recent C-Suite Series report focusing on Credit Solutions describes how businesses that use the full range of credit solutions available to them will gain a competitive advantage. Aon estimates that 20% of large corporates are making full use of credit solutions. The remaining 80% are missing out on crucial tools with which to pursue sustainable growth while optimising their cash flow and working capital.

The credit solutions discussions we now have with the treasury and C-Suite are wholistic, involving a working capital 360° assessment to understand how credit insurance and other tools can be used to support financing and growth. That means looking closely at receivables, payables, guarantees and investments, picking out key figures from each of those areas and applying those to the three core credit related product areas: trade credit, which is short-term receivables focused; structured credit and political risk, as well as surety as an alternative to bank guarantees.

Lessons learnt from the Global Financial Crisis (GFC)

Structured credit and political risks insurers provide non-cancellable cover and these products were tested and performed well during the GFC. For long-term purchasers of these products, we foresee the relationships being strengthened, particularly for those insurers that take supportive capacity positions as trade volumes pick up. We also expect to see new users as the relevance of these products grow.

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The trade credit insurers however took significant actions during the GFC around credit limit cover reductions. So the big question is, have the trade credit insurers learnt the lessons from the GFC in 2007/08?

This is their first big test since then, but the positives are that they now have more financial information on risks, better analytic capabilities and strengthened capital models. These should be reflected in a longer-term approach and more stability for clients. As we comment in our 19 March **'COVID-19 impact on Trade'** report, clients can also help by taking proactive action to help insurers better manage their risk portfolios. For example, regular communication and sharing of risk information will allow insurers to better assess the actual risk exposure underneath the total potential limit exposure.

So far, our general experience has been that compared to the GFC, the mono-line trade credit insurers (which hold the majority market share) are communicating better, with more measured approaches to credit limit action. Unfortunately, we have also observed specific insurer examples where this has not been the case and we expect those insurers will see a negative impact to client retention in the medium term.

Our Aon teams are working with clients across countries and regions to maximise cover and we are leveraging our Chief Broking Officer and Global Client Team infrastructures, our Data & Analytics as well as our Risk Analyst capability to take proactive steps to maintain insured credit limits where necessary. Our view is that stronger client relationships will be formed with those trade credit insurers that are able to make composed and sensible decisions amidst the crisis.

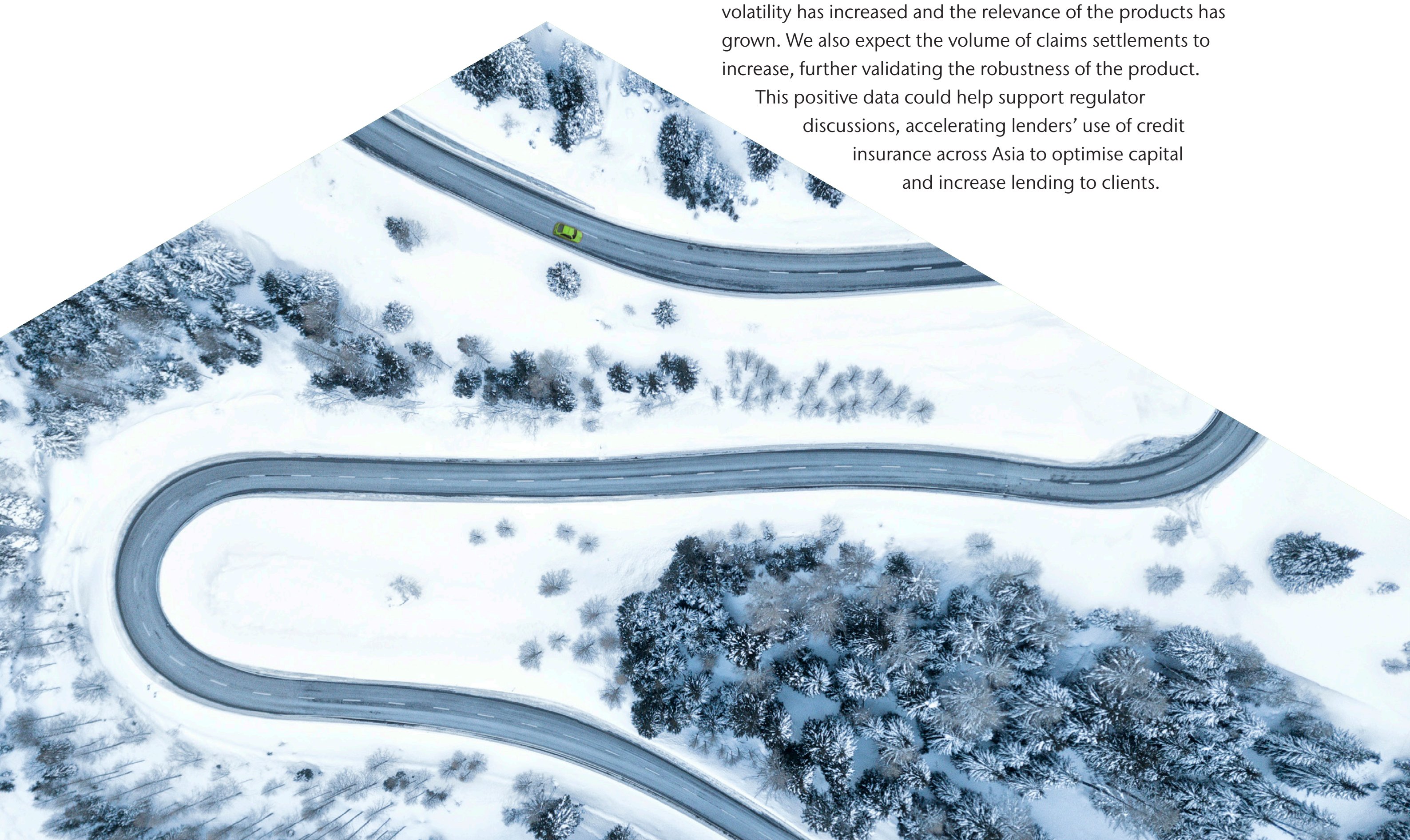
Looking forward – a different approach and increased lending?

In Asia as an example, on the short-term receivables side, the predominant product is multi-debtor, cancellable credit insurance. While there are fewer Excess Of Loss non-cancellable structures, the impact of the current crisis might get larger corporates thinking more broadly about non-cancellable structures; to take in more of a risk share at the outset but have more certainty and sustainability over the limit coverage in difficult times such as now. Some thought this would happen post-GFC – it did not to the extent predicted, but will it now?

There will be supply chain challenges. Many corporates will represent a credit risk themselves in respect of payment to their suppliers and payments to their banks. Credit insurers may be providing large amounts of capacity on these businesses. Corporates need to ensure they can help creditors secure credit capacity on themselves as a risk; that means better transparency in terms of financials, cash flow and bank facilities. Your broking advisor can help you gain a better understanding of your risk profile and identify unutilised credit capacity on your business, which could then be used on the payables side of the balance sheet to free up much needed liquidity.

As we comment in our Credit Solutions C-Suite Series report, one area where credit insurance has proved its worth is in helping banks and financial institutions to lend more to clients across multiple asset classes. As the impact of COVID-19 unfolds, the trend of credit downgrades could impact lenders' capital models, so we will also be monitoring closely how lenders' use of credit insurance responds.

We expect to now see higher demand, given credit risk volatility has increased and the relevance of the products has grown. We also expect the volume of claims settlements to increase, further validating the robustness of the product. This positive data could help support regulator discussions, accelerating lenders' use of credit insurance across Asia to optimise capital and increase lending to clients.



Start planning now

While the short term might see tougher times as credit capacity restricts, the time is ripe for CFOs and treasury teams to be thinking about how they can use credit solutions to not only protect against bad debt, but to move into other areas such as unlocking working capital and maximising balance sheet efficiency.

While immediate credit insurance capacity may be limited, solution planning should start now for the medium and longer term given the sales cycle for these products can be up to six months, sometimes longer. Emerging from this crisis we might see a different landscape but credit solutions will be an important strategic tool for corporates and lenders. Perhaps - for trade credit insurance - there will be more focus on different, non-cancellable structures, backed by an increasing use of digital solutions as a way of improving capacity management, process and communication. In any case today is the time for both insurers and clients in this market to think long-term.

For more insights around Credit 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.

About Aon

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