Aon Risk Solutions
Credit Solutions

Trading Perspectives

Focus on USA

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In this publication

Foreword

The United States of America (U.S.) is a federal republic mainly composed of 50 states, a federal district, and five major self-governing territories. At 3.8 million square miles and a population of over 325 million people, the U.S. ranks in the top 5 world largest countries by total area and is the third-most populous. The extremely diverse geography, climate, and wildlife of the United States make it one of the world's 17 megadiverse countries, as defined by Conservational International.

The United States accounts for approximately a quarter of global GDP. The economy is largely post-industrial, characterized by the dominance of services and knowledge-based activities, although the manufacturing sector remains the second-largest in the world. Though its population is only 4.3% of the world total, the U.S. holds 33.4% of the total global wealth.

The U.S. dollar is the currency most used in international transactions and is the world's foremost reserve currency. Its largest trading partners are China, Canada, Mexico, Japan, Germany, South Korea, United Kingdom, France, India and Taiwan. The U.S. has one of the world's largest and most influential financial markets; the New York Stock Exchange is by far the world's largest stock exchange by market capitalization.

Foreign investments made in the U.S. total almost $2.4 trillion, while American investments in foreign countries total over $3.3 trillion.

The local credit insurance market is continuously developing, primarily through i) global programme expansion, ii) bank related financing instruments (Asset Based Lending/Factoring/Supply Chain Financing) and iii) Excess of Loss, non-cancellable policy structures. Recent high profile insolvencies, particularly in the retail sector, have also highlighted the value of protecting against unexpected bad debt losses.

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The U.S. market environment

A slow, uneven recovery following the financial crisis

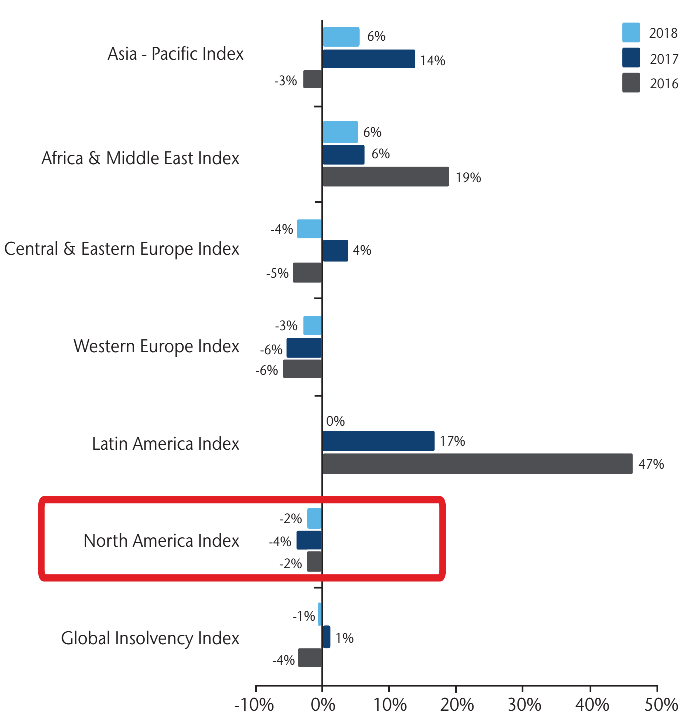
Despite facing challenges at the domestic level along with a rapidly transforming global landscape, the U.S. economy is still the largest and most important in the world. The U.S. economy represents about 25% of total global output, and is still larger than that of China (18%). The U.S. economy features a highly-developed and technologically-advanced services sector, which accounts for about 80% of its output. Business activities are dominated by services-oriented companies in areas such as technology, financial services, healthcare and retail.

	Economic growth (% GDP)	Public debt (% GDP)
2016	1.6	105.8
2017(e)	2.2	105.4
2018(f)	2.5	105.6

Source: Euler Hermes

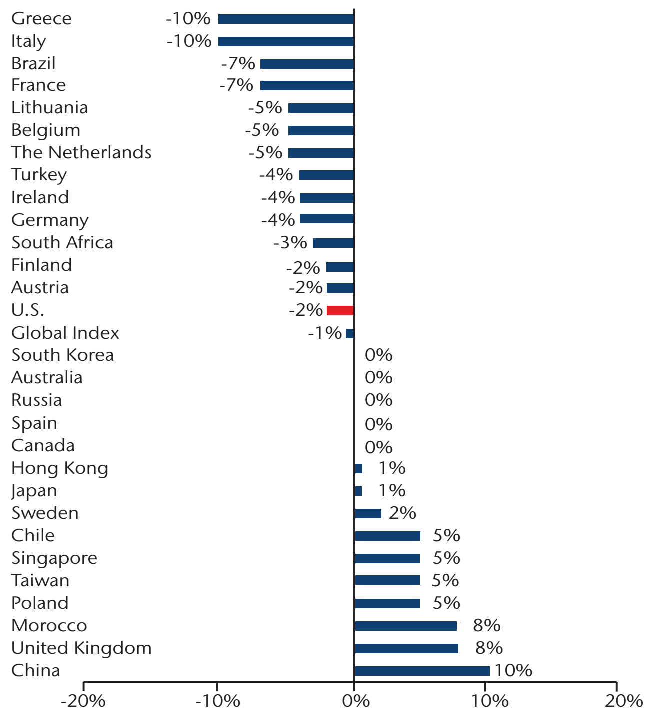
The U.S. economy went through an economic downturn following the financial crisis of 2007–08, and the economy began to recover slowly yet unevenly since the second half of 2009, for instance receiving support through expansionary monetary policies. This includes not only holding interest rates at the lower bound, but also the unconventional practice of the government buying large amounts of financial assets to increase the money supply and hold down long term interest rates, a practice known as “quantitative easing”.

Business insolvencies by region – YoY variations



Source: Euler Hermes

Business insolvency variations 2018 vs 2017 (expected)

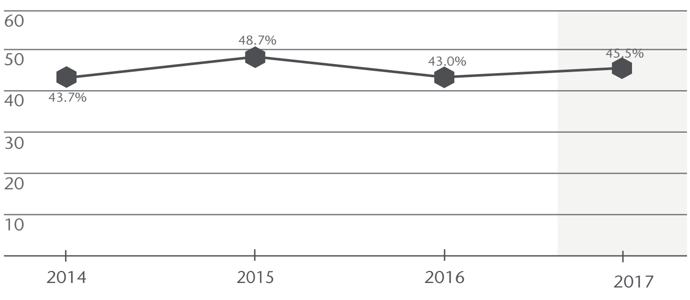


The US Chapter 11 bankruptcy code, which can be used by large struggling businesses seeking to restructure their debt, allow for organizations to continue to operate under the supervision of the court while delaying payments to creditors. The rules are typically seen as flexible and more widely used than its European equivalents.

Mark Powell | Risk Analysis | Aon Credit Solutions

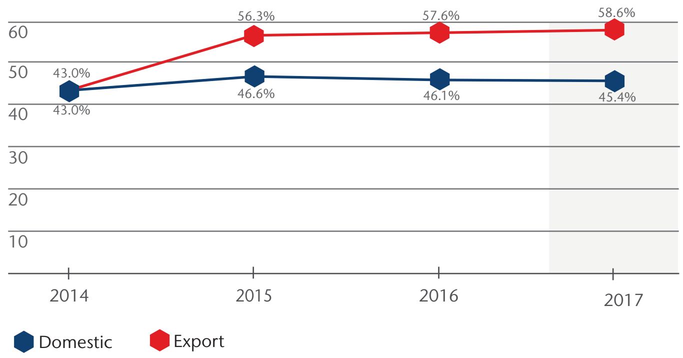
Payment practices

B2B sales on credit in the US (average %)



Source: Atradius Payment Practices Barometer

Past due B2B receivables in the US (average %)



With 45.5% of B2B sales on credit terms, businesses in the U.S. seem slightly more inclined to use this method of payment than in 2016 (43.0%). The increase in the proportion of total B2B sales on credit in the U.S. contrasts with Europe, where B2B sales on credit terms declined slightly from 41.0% in 2016 to 40.0% in 2017.

The percentage of overdue B2B invoices on domestic business has been relatively flat around 45%, while overdues on export transactions have been increasing steadily to 58.6% in 2017, after a surge in 2015.

Insurer perspectives

The insurers' overall country analysis consistently underpins their specific client decisions around credit limits. It is therefore critical to monitor insurer's assessment of the overall business environment, in order to pro-actively address current and future credit capacity challenges in the U.S.

Insurers are reporting that the U.S. macro-economic developments shown below influence their local business.

	Key trends identified/reported
AIG	Major U.S. tax overhaul increases potential for higher domestic U.S. inflation and interest rates.
	Federal tax may fall by over $1 trillion over a decade, raising the government deficit and debt.
	Threat of trade tensions as a result of U.S. trade tariff actions may increase the risk of recession.
Atradius	Economic growth is gaining momentum.
	Trade policy remains a downside risk.
	Comprehensive tax reforms provide additional stimulus.
Coface	Attractive market: leader in research & innovation, huge market.
	Polarisation of political landscape.
	The predominant role of the dollar in the global economy.
Euler Hermes	Claims remain at high levels across most sectors and competition remains fierce.
	A combination of points above and the client cash flow difficulties creating pressure on premium rates.
	Lackluster growth in our client sales is another indicator of a subdued trading environment.
QBE	The underlying economy is growing at a healthy pace.
	Tax reform both businesses and individuals will provide a lasting stimulus and boost to consumer confidence.
	Pending trade war with China, especially if there is escalation in tariffs, is a negative force to the overall economy.

Country risk assessment

Aon perspectives - U.S. market in focus

Favourable near-term projections

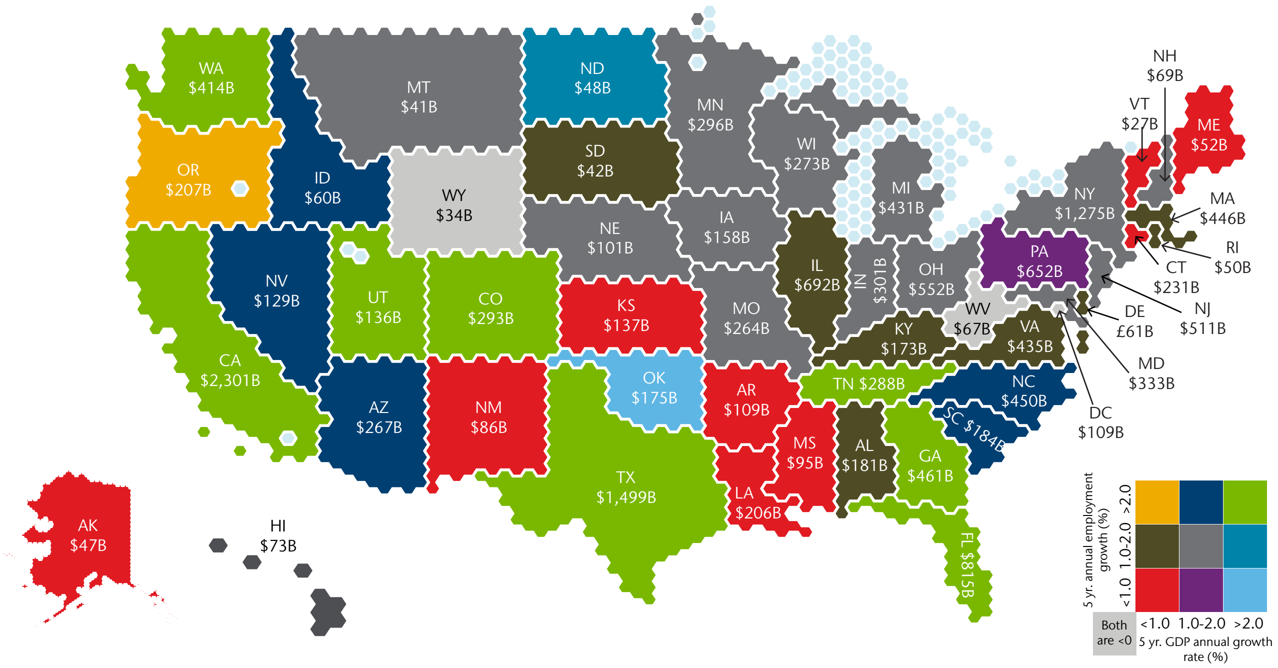
The U.S. economic outlook is healthy according to the key economic indicators. GDP growth rate is expected to remain between the 2% to 3% range, with consumer spending forecasted to continue to grow at a moderate pace, supported by solid fundamentals.

Investment spending should remain solid. Business cash flows are strong, and the corporate sector is set to receive a meaningful lift from the recently enacted tax legislation. The large reduction in the statutory corporate income tax rate from 35% to 21% and the 100% expensing provision for investment should also drive down the effective cost of capital for business.

In addition, the U.S. economy should be well supported by the recent improvement in the global economic outlook. Recoveries in Europe and Japan, and a revival of growth in many emerging market economies, should ensure that demand for U.S. goods and services remains strong.

Gross domestic product overview

A varying GDP picture by state



Green and dark blue indicates states with both the highest predicted GDP and job rate growth, red is for states with the lowest predicted growth for both. All other colours indicate a mix of higher and lower growth rates, as indicated on the map key.

Source: howmuch.net

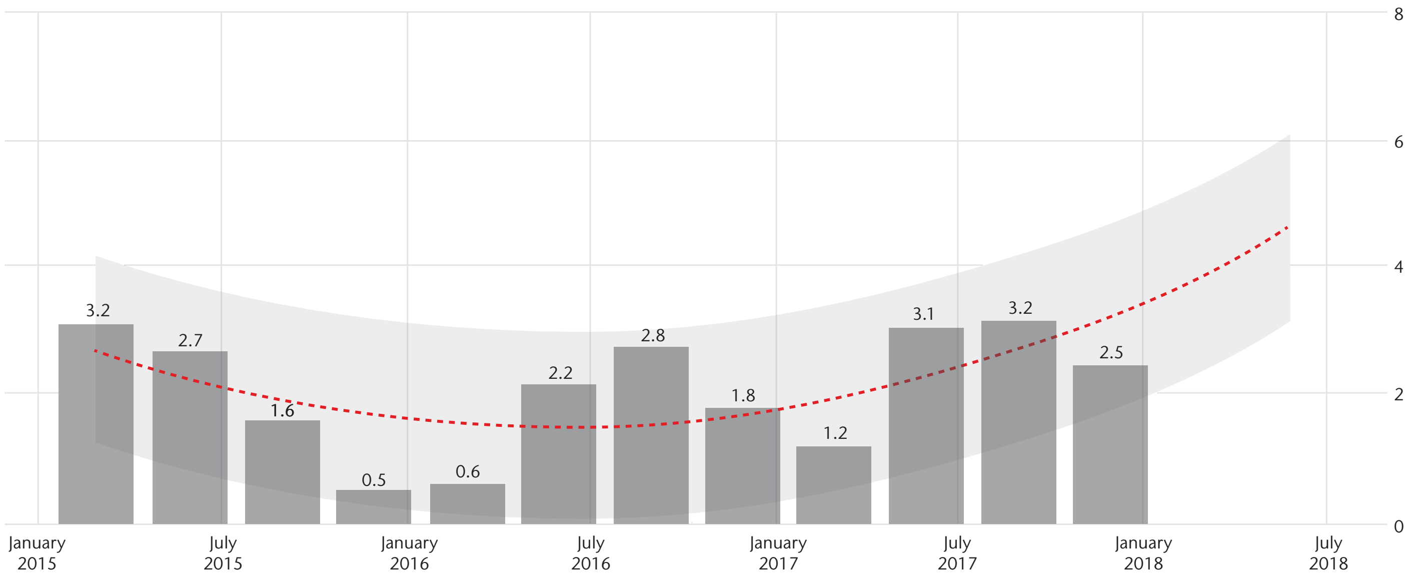
> The whole U.S. economy, regarding production and employment, is now back at pre-recession levels. When broken down, the recovery remains uneven with some states like Florida and California performing well while others such as Kansas, Connecticut, and others, just back to level.

Economists polled by Reuters had forecast the overall U.S. economy growing at 3% in the final three months of 2017.

The economy grew 2.2% in 2017, acceleration from the 1.6% logged in 2016. Economists expect annual GDP growth will hit the government's 2.5% target this year, spurred in part by a weak dollar, rising oil prices and strengthening global economy.

Strong domestic demand is part of a synchronized global rebound that includes the euro zone and Asia. Demand has also been buoyed by President Donald Trump's promise of hefty tax cuts, which was fulfilled in December when the Republican-controlled U.S. Congress approved the largest overhaul of the tax code in 30 years.

Historical trend since 2015



Source: www.tradingeconomics.com

Protectionism and tariff trends

The U.S. is perceived to have increased protectionist measures since President Trump entered the White House. This development looks to go against current trends elsewhere around the globe, where 467 new protectionist measures were implemented in 2017, compared to 827 one year earlier.

The U.S. was responsible for implementing 90 new protectionist measures last year, up from 84 in 2016. Digging down a little deeper, data indicates that the U.S. decided to bolster measures to counteract perceived protectionism from key competitors. The number of import tariff measures increased to 30 in 2017 from 6 in 2015, while anti-dumping measures rose to 20 from 13.

The expected clash was particularly visible as China was widely in the U.S's scope, targeted in 2017 by 17 new measures from 8 in 2016. The example of a recently implemented 30% import tariff on Chinese solar panels suggests that this momentum will be sustained in 2018.

The current U.S. administration also voiced concerns about an imbalance in its trade relationship with Mexico. In this regard, the current data is contrarian: the U.S. did increase its trade barriers, especially against Canada (18 new measures in 2017) while Mexico was barely hit (only 2). More protectionism against Mexico is perceived to be self-defeating for U.S. corporates' business models, since they use the low labour cost in Mexico to stay competitive. The most targeted sector in Canada was energy, in a frontal competition on shale oil & gas with the U.S.

Tremors in the retail sector

Trends supporting credit insurance expansion expectations are considered to be linked to three primary drivers: banks desire to monetize receivables, corporate bankruptcies, and distressed retail markets.

Although retail nominal sales are at an all-time high and the 2017 Christmas holiday sales set a new record, this growth is not being experienced in the same fashion by all players. The U.S. market, which represents the highest rate of retail space per person by far, is being heavily disrupted by online sales channels, particularly Amazon. This transformation is having direct and immediate impact on the financial health of established retail outlets with significant bankruptcies observed. Out of the 10 largest retail company failures in 2017, 9 occurred in the U.S. (for example Toy "R" Us, Payless, and Marsh Supermarkets), against only 4 out of 10 in 2016.

We expect these market challenges to be carried forward into 2018 and beyond, with an increasing number of retail businesses experiencing financial difficulties.

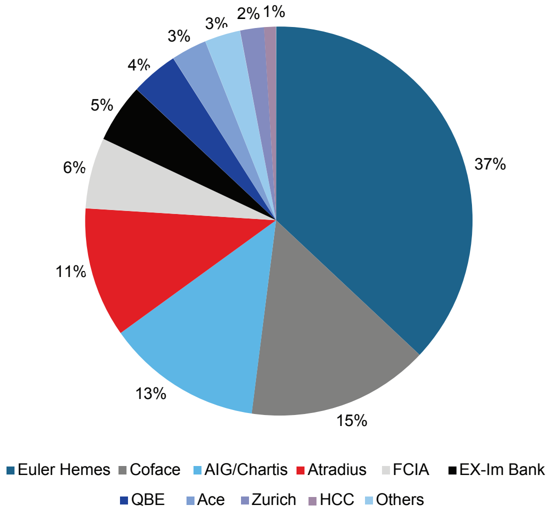
Credit insurance capacity

Impact on insurer behaviours

The combined analysis of the U.S. overall economic condition and the counterparty risks enables us to anticipate the need for new innovative solutions to be developed and delivered for our clients.

Sector	Risk appetite
Agriculture	Average
Automotive	Average
Chemicals	High
Construction	Average
Construction materials	Average
Consumer durables	Average
Electronics	High
Financial services	High
Food	High
Engineering	Average
Metals	Low
Oil / gas	Average
Paper	Low
Retail	Low
Services	Average
Steel	Low
Textiles	Low

U.S. domestic insurer market share



These are estimates based on Aon's market knowledge.
No formal publications available.

Market trend overview

The Excess of Loss (XoL) market continues to increase in popularity. The market options are extensive and many of the established insures are strengthening their XoL teams. For instance, Euler Hermes World Agency has added XoL resources to its U.S. based team.

Although Ex-Im Bank support to US businesses has been perceived to be inconsistent in the last few years, recent initiatives (e.g. USD 1 billion reinsurance program arranged via Aon Benfield) might create a more positive outlook.

Bank deals continued to show growth and supply chain financing was a common focus area for large multinationals in 2017.

Loss ratio

The loss ratio in the U.S. credit insurance market is estimated to have increased to an average of around 50-60% in 2017. Many of the losses are considered coming from discretionary credit limit buyers and retail sector insolvencies.

Pricing

Increasing insolvencies and a slowdown in new market capital had pushed pricing upwards in 2016; however we saw this stabilize in 2017. We have also observed that changes to client policy structure changes have been implemented to curb the increase in premium rates/spend.

Premium rates are projected to experience a flat to slight increase trend in 2018.

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In practice

Over the years during which Aon has been operating and designing credit solutions in the U.S. market, we have been approached to implement U.S. domestic whole turnover credit insurance policies as well as various syndicated single risk programs for domestic and export transactions.

Below are three case studies relating to credit insurance solutions arranged by Aon teams.

Case study 1

Enabling exports despite insurance market capacity constraints

Insured:	International manufacturer of crop protection products
Obligors:	Domestic and exports
Sum insured:	USD 1,000,000,000

- Aon proactively identified potential issues with its exports into Brazil and the related insurance market capacity constraints which could negatively affect local business growth.
- Our team successfully managed to limit the impact of key insurer's current overall plans to reduce their credit limits in Brazil.

Case study 2

Working capital improvements

Insured:	Global Life Sciences conglomerate
Obligors:	Whole turnover credit insurance policy and single risk
Sum insured:	USD 800,000,000

- Aon performed a detailed benchmarking review of the company's credit risk management and insurance purchasing practices.
- Our team worked closely with the internal credit team to find improvement areas that would eventually be reflected in the financial statements, with a strong focus on working capital.

Case study 3

Unlocking additional sales

Insured:	Global technology company
Obligors:	Domestic
Sum insured:	USD 50,000,000

- Our client was confronted with an excess supply of technology equipment, which created a concentration credit risk with the key distributor willing to purchase the items.
- Our team had the difficult challenge of finding $50 million of insurance cover on the distributor where insurance appetite and capacity was very restricted, even on relatively short terms of trade (45 days). Eventually a program was structured involving a syndication of three different insurers.

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About Aon

Aon plc (NYSE:AON) is a leading global professional services firm providing a broad range of risk, retirement and health solutions. Our 50,000 colleagues in 120 countries empower results for clients by using proprietary data and analytics to deliver insights that reduce volatility and improve performance.

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