Aon Risk Solutions
Credit Solutions

Trading Perspectives

Focus on the UK

August 2018

Market Insights

Insurance Capacity

Technical Advice

In this publication

Foreword

The United Kingdom (official name: United Kingdom of Great Britain and Northern Ireland), a parliamentary democracy with a constitutional monarch, consists of four countries united under one government. The UK is one of the three largest economies in Europe with Germany and France. It was an active member of the European Union (EU) from 1973 to 2016, although it chose to remain outside the Economic and Monetary Union. On 23 June 2016, UK citizens narrowly voted to leave the EU.

With fewer than nine months to go until the UK begins its formal process of leaving the EU, politicians, business leaders and workers are gearing up for considerable change. After a planned transition period that runs until 2020, the UK government has proposed a “soft Brexit” arrangement with two main features: a “free trade area for goods,” which will allow current trade rules to continue, and a “facilitated customs arrangement” that allows the UK to collect tariffs on behalf of the EU and pursue its own trade policy. However, this plan has yet to be agreed upon by the EU – and does not have the backing of some UK politicians, aiming for a “hard Brexit”.

The most important sectors of the UK’s economy include finance, wholesale and retail trade, transport, accommodation and food services, public administration, defence, education, human health and heavy industry. The UK’s main export partners are the US, Germany and Switzerland, while its main import partners are Germany, China and the US.

According to economic studies published, GDP growth is projected to remain modest at around 1.2% in 2018 and 1.3% in 2019, owing to uncertainties about the outcome of Brexit negotiations. Inflation is projected to fall gradually to slightly above the 2% target of the central bank by the end of 2019.

Credit risk profiling in the UK is changing for many businesses, following recent high-profile insolvencies, including Carillion and Palmer & Harvey. Experts have specifically warned that the retail industry is on “high alert” following the release of 2017 insolvency figures, which revealed rising liquidation rates.

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The UK market environment

Decline in economy activity?

	Economic growth (% GDP)	Public debt (% GDP)
2016	1.8	89.3
2017(e)	1.5	86.9
2018(f)	1.2	87.2

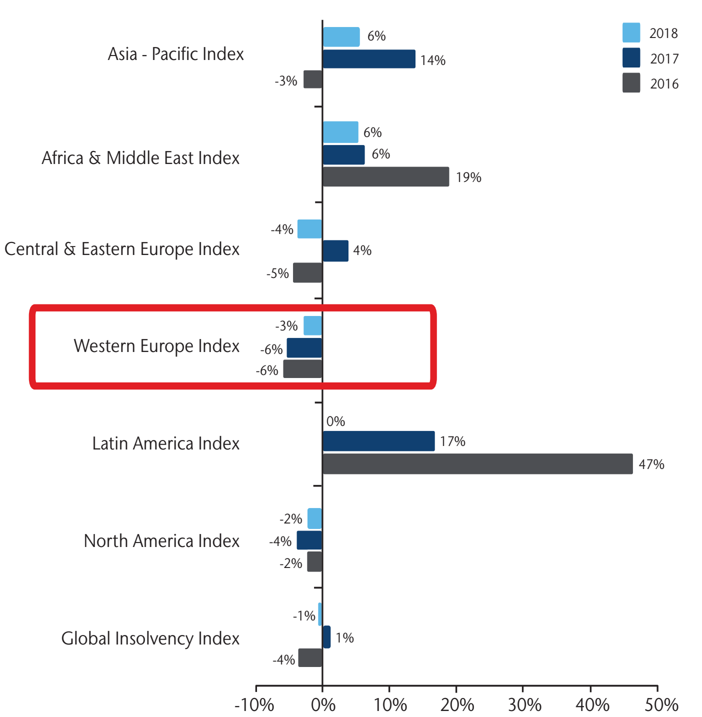
Source: Coface

Growth, still suffering from uncertainties associated with Brexit, is expected to weaken in 2018. Household consumption, which represents over 60% of GDP, is set to continue to slow. While inflation, following the depreciation of the British pound after the referendum, is outstripping nominal wage growth, the pressure on household disposable income is expected to persist, leading to an erosion of consumer confidence. The slowdown in domestic demand has already impacted the automotive sector, which posted a fall in new registrations in 2017. The contribution of private investment is expected to fall, with businesses choosing to delay their investment decisions due to political uncertainty.

The fear of a post-Brexit slowdown and the rising cost of credit, following the hike in the benchmark interest rate, will continue to weigh on the construction sector.

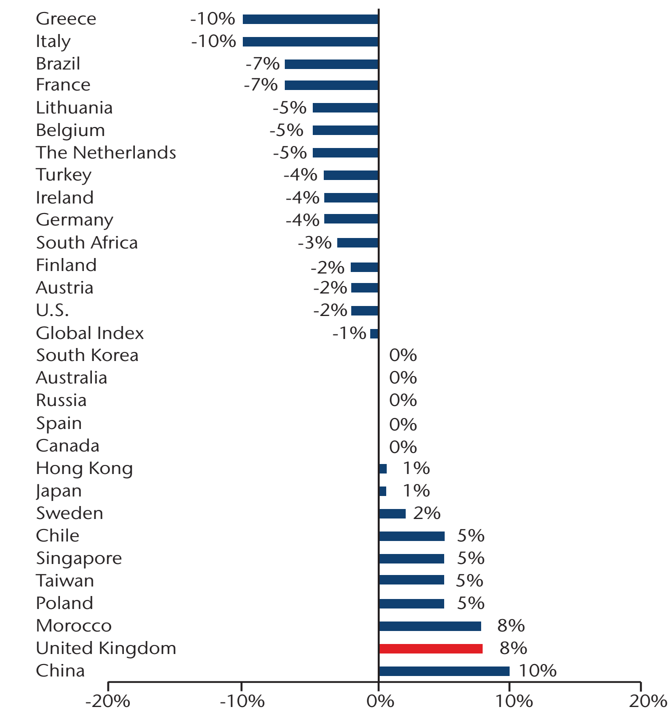
Despite a more accommodative fiscal policy, the contribution of public consumption will likely remain weak. Buoyed in 2017 by a devalued pound and by robust demand in EU partner economies, exports should continue to contribute positively to growth in 2018. The effect of the pound's depreciation on export competitiveness is, however, likely to ease, reducing the contribution of exports to growth. The economic slowdown could be reflected in a rise of about 8% in bankruptcies.

Business insolvencies by region – YoY variations



Source: Euler Hermes

Business insolvency variations 2018 vs 2017 (expected)

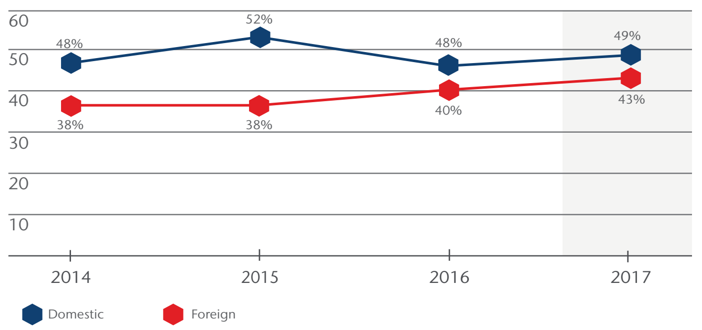


The increase in the UK contrasts with the rest of the European Union where the level of failures will decrease by an average -3% this year. France (-7%) , Germany (-4%), Netherlands (-5%) and Belgium (-5%) will all see considerable falls due to the economic recovery across the EU and supportive monetary conditions.

Mark Powell | Risk Analysis | Aon Credit Solutions

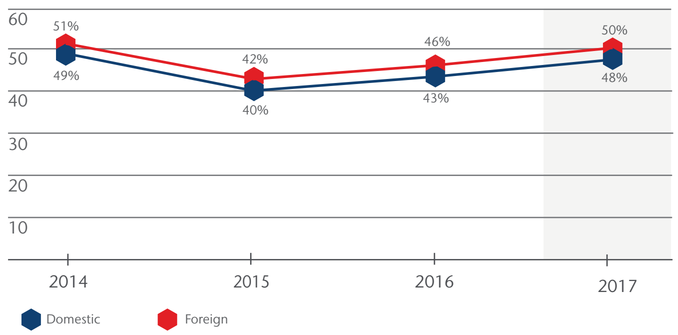
Payment practices

B2B sales on credit in the United Kingdom (average %)



Source: Atradius Payment Practices Barometer

Overdue B2B receivables in the United Kingdom (average %)



After a slight decrease in sales on credit terms in 2016, the total value of B2B sales on credit in the UK increased again this year. Among the Western European countries surveyed, respondents in the UK (45.7%) are some of the most inclined to sell on credit terms.

Around half of the invoices of respondents in the UK were not paid by the due date (49%). This is four percentage points higher than in 2016 and higher than the 41% regional average.

Insurer perspectives

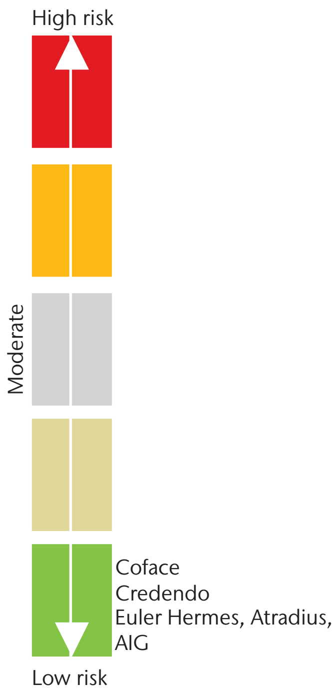
The insurers' overall country analysis consistently underpins their specific client decisions around credit limits. It is therefore critical to monitor insurer's assessment of the overall business environment, in order to proactively address current and future credit capacity challenges in the UK.

Insurers are reporting that the UK macroeconomic developments shown below influence their local business.

	Key trends identified/reported
AIG	The recent UK Government White paper highlights a Softer Brexit, this bodes well for the UK economy
	The UK GDP growth is still growing however this is at its slowest rate of growth since 2009
	In Q1 2018, claims surged 50% compared with Q4 highlighting the relevance of Non-Cancellable credit coverage
Atradius	Exports have benefitted from increased international competitiveness
	British business insolvencies expected to rise sharply in 2018 overall
	Economic prospects are steady but fragile, subject to various uncertainties, including around Brexit
Coface	Hydrocarbon production covering three quarters of energy needs
	Uncertainty over the implementation and consequences of the decision to leave the EU
	Cutting-edge sectors (aeronautics, pharmaceuticals, automotive) brings strength to the UK market
Euler Hermes	There are specific supportive economic and fiscal policies by the UK government
	High current account balance deficit remains a concern
	Diversified export structure brings positive balance to the overall economy
Credendo	Modest economic growth is set to continue throughout 2018 and 2019
	Increased interest rate hike cannot be permanently delayed
	Inflation continues to erode purchasing power and consumer confidence

The overview above is a summary only, obtained from insurer country reports as applicable. It is not intended to be an exhaustive list.

Country risk assessment by insurer



Aon perspectives - UK market in focus

Economic growth and credit risk

Credit risk profiling in the UK is changing for many businesses, following recent high profile insolvencies. Groceries wholesaler Palmer & Harvey is an example of risk which has been poor for a long time, due to the well-published debt burden and a changing business model. It is a failure that many could say they saw coming for a while.

In comparison, however, Carillion deteriorated rapidly and went from a stable position (being awarded many government contracts) to insolvency within around 18 months. As reported in the press the failure of Carillion took many sub-contractors by surprise, but has called into question why businesses have not considered credit insurance, and subsequently a potential domino effect in the supply chain as a possibility. Figures suggest that more than $30 million in cover will be paid out to companies claiming for non-payment of invoices.

In this context, overall bank lending, for example, is still proving hard to come by in a challenging economic environment, many businesses are turning to supply chain finance as an alternative way to boost their working capital. One of the main benefits being it is an unsecured line of credit and does not impact on the business's existing finance arrangements. Supply chain finance allows businesses to pay its suppliers via an approved bank while the business itself can benefit from extended credit terms.

GDP trends in the UK, compared to Euro area and the US

*Covers 16 countries that are both euro area and OECD members
**Harmonised measure
Source: OECD Economic Outlook 103 database

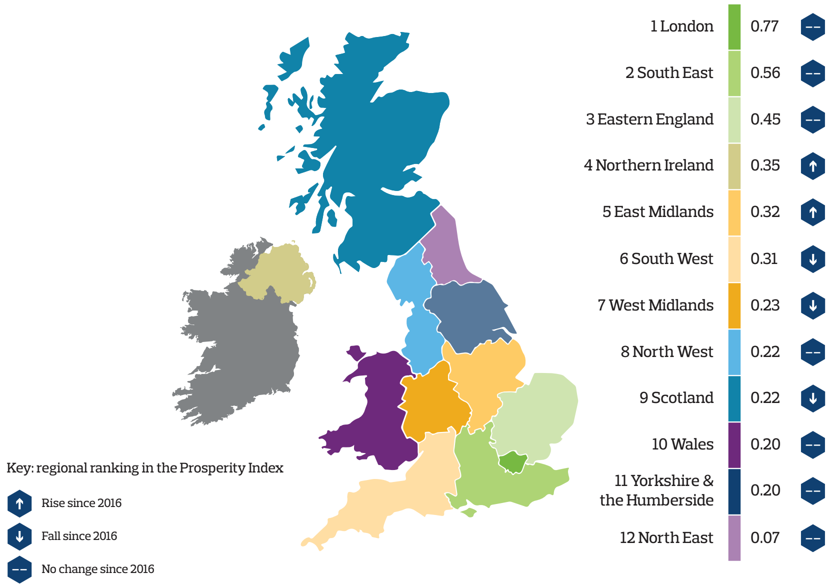
Slow fiscal consolidation

While the economy is facing a less favourable context and is still struggling to overcome certain structural weaknesses, such as anaemic productivity growth, the pace of fiscal consolidation is expected to ease. In particular, cuts to current expenditures are expected to be smaller than initially foreseen. Although these measures are unlikely to stop the downward path of the deficit in 2018, financing them is expected to push up the debt ratio, which came down due to an accounting change in 2017.

The current account balance will continue to show a deficit in 2018. After benefiting from a buoyant global trade environment and the pound's depreciation in 2017, the balance of goods deficit is expected to increase slightly in 2018. This will not be offset by the services surplus. Even if it could recede, the income balance deficit, which has widened since the start of the decade in connection with the decline in investment income, will continue to impact the current account balance. Transfers, which make a low contribution, are not expected to influence the current account overall balance.

An overview of UK prosperity by region

The UK Prosperity Map has been researched and compiled by Barclays, ranking UK regions and cities in terms of their affluence and using factors such as GDP per capita; unemployment rate; average weekly household expenditure; the proportion of pupils with A*-C GCSE grades; mean gross annual pay; business birth-to-death ratio and insolvency rate. The index scores have a scale that runs from 0 to 1. If a region had the highest score across all factors, it would achieve an index score of 1; and if a region scored the worst across all factors, it would achieve an index score of 0.



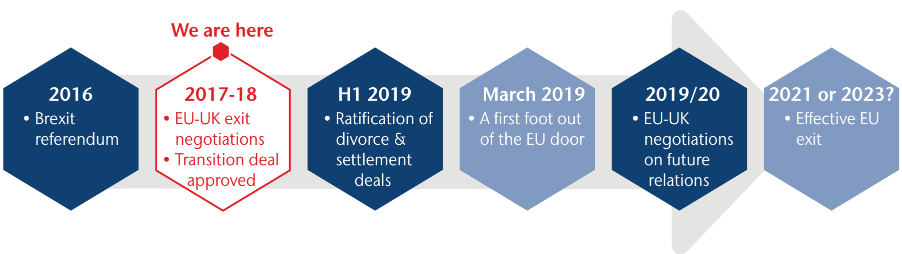
Cities are outpacing their wider region, with clear disparities opening up when it comes to GDP per capita and earnings. London remains in 1st place with expenditure growth of 5.9% and the highest GDP per capita, despite only growing by 1.6%. Although the North East has kept its 12th place position, the region saw a 4% rise in house prices and a 2.8% rise in GDP.

Thorny Brexit negotiations on the agenda of a weakened government

Businesses benefitting from the smooth running of the borderless supply chains that cross the EU are wary that Brexit will mean an end to that efficiency. And EU firms with exports to the UK are weighing the potential impact of new customs policies, and tariffs.

After triggering Article 50 of the EU treaty governing the EU withdrawal process in March 2017, Prime Minister Theresa May called early general elections so that she could begin Brexit negotiations from a position of strength. However, the elections saw Theresa May's Conservative party lose its absolute majority in the House of Commons - which was seen as a significant setback.

From its weakened negotiating position, the government nonetheless managed to conclude the first phase of talks with the European Commission, reaching agreement on the EU divorce terms. The Irish border issue and the topic of future relations and trade agreements with EU countries are even more sensitive, with the effective exit date of 29th March 2019 looming.



As the details of the UK's Brexit remain uncertain, businesses are considering a variety of options to address any anticipated fallout. The UK auto industry, for example, blames uncertainty over Brexit's impact on supply chains for a decline in industry investment in 2017. The industry's response to the uncertainty is to move new investment to locations safely within the EU's customs zone.

European aircraft manufacturer Airbus is also concerned with the supply chain concerns that a Brexit could create. Airbus, which makes wings for its passenger aircraft in the UK, says the absence of such a deal would threaten its long-term presence in the country.

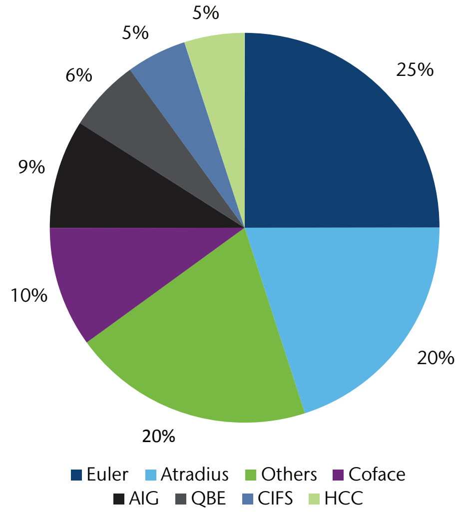
Credit insurance capacity

Impact on insurer behaviours

The combined analysis of the UK 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. The table shows Aon's insight and perspective into insurer's overall risk appetite by sector.

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

UK domestic insurer market share



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

Market trend overview

High profile company failures included Monarch Airlines, Palmer and Harvey and Misco, which have continued into 2018 with the collapse of Carillion, Toys R Us and Maplin. UK firms continue to face challenging trading conditions at home and abroad.

Brexit continues to dominate the risk horizon and pricing is slowly increasing as a result. Risk appetite has peaked in certain sectors, and the top-up market continues to grow as a result.

Loss ratio

The overall market loss ratio in 2017 was estimated at 25-30%. However, the number of claims made by UK firms in the first quarter of 2018 to cover non-payment of debts were at their highest level since 2009 according to data published by the Association of British Insurers.

Pricing

The UK market premium and number of policies have been reasonably static over the past 5 years, but now increasing. We are observing a moderate increase in premium rates after a significant period of decline pricing.

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In practice

Over the years during which Aon has been operating and designing credit solutions in the UK market, we have been approached to implement UK domestic whole turnover credit insurance policies as well as various syndicated single risk programmes for domestic and export shipments. More recently, we have observed that market conditions and client buying behaviours are being driven by globalization and financing needs. This increases the need for the continuous product innovation, which specifically our Structured and Capital Solutions competence has been focusing on.

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

Case study 1

Supporting growth and enabling financing

Insured: International mining company

Obligors: Domestic and exports

Sum insured: USD 2 billion in credit exposures

- Our international team works to leverage our Structured and Capital Solutions expertise around i) steel sector risk analysis and ii) London capacity market access.
- The designed structure allows our client to access cost efficient receivable purchase solutions whilst controlling the procurement and management of the programme.

Case study 2

Programme underpinned by insights

Insured: Global Life Sciences conglomerate

Obligors: Whole turnover credit insurance policy, non-cancellable credit limits

Sum insured: USD 800 million turnover

- Our team focuses on providing industry knowledge and insights with analysis over risk rating of the key buyers to illustrate the potential exposures within their portfolio.
- The solution is designed to improve the competitive position of our client by providing flexibility around increasing the covered exposures whilst helping to protect the organisation against unexpected bad debts.

Case study 3

Tailored insurance structure

Insured: Large Food & Drink company

Obligors: Domestic

Sum insured: USD 900 million turnover

- Our team secured a significant credit line for 12 months, retaining a level of risk thereby reducing the cost. The line was underwritten against credit control processes to minimise the impact.
- By performing a detailed review of the sales ledger, our team is able to highlight risks and develop an insurance programme with non-cancellable limits and appropriate level of underwriting discretion.

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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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