The trade credit market - starting to innovate?

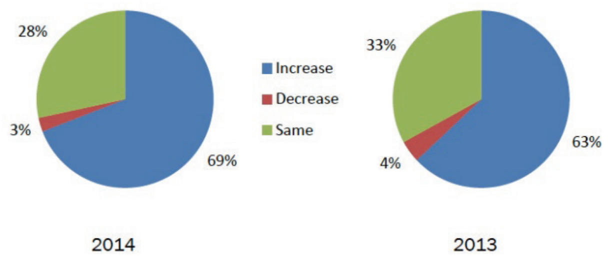
The trade credit insurance (TCI) industry is emerging from a crossroads, where the market leaders have responded to the events of 2008-09 by beginning to provide more innovative products that offer greater certainty. In the UK, exports are clearly rising again in the wake of the financial crisis, but the risks of trading overseas are equally ascendant, demonstrated by the political violence linked to the Islamic State (IS) in the Middle East, the dire tensions between Russia and Ukraine, and Argentina's latest debt default.

In the light of these trends, protection against the risk of non-payment, via products that can be used with complete confidence, is absolutely essential, stresses Will Clark, Head of Trade Credit at AIG in the UK. "Any credit manager knows that their company's lifeblood is cash, and that bad debt can have a catastrophic effect on liquidity. The key is to treat credit risk as a key component in strategic planning and dealing with the harsh prospect of key clients or markets facing difficulty. The hard truth is that new credit risks can spring from anywhere, as happened within Eastern Ukraine, and it is always too late to protect yourself once the trouble has begun."

Much-improved products, made easier to administrate by technology, are a critical and indispensable part of the TCI industry's evolving stance, says Clark. "In particular, innovation has been led by greater proliferation of excess of loss, non-cancellable cover, to exporters and other companies that traditionally purchased 'ground-up', whole turnover products."

Clark points out that TCI clients that have used truly non-cancellable cover products in higher-risk markets such as Argentina, Russia and Ukraine have seen their credit limits kept in place for 12 months after inception or renewal. "The non-cancellable aspect stops credit insurers from reining back or withdrawing their credit limits, actions that earned our industry a bad reputation in some quarters five or six years ago."

Do you see your dependency on export business increasing or decreasing over the next five years?



International Trade Survey 2014

Risk awareness

With UK Treasury figures citing a huge 78% climb in exports to fast-growing emerging economies, and the British Chamber of Commerce predicting export growth to increase by 4.1% and 4.6% in 2015 and 2016 respectively, the case for addressing the gamut of international trading risks can hardly be under-stated for the growing numbers of UK-based exporters. Yet few companies, especially lesser-resourced SMEs, are aware of just how bad debt can cripple a firm.

According to the *International Trade Survey 2014*, sponsored by AIG, 69% of respondents expected to depend more on exports over the next 5 years, compared to 63% in 2013.

Yet just 9% of participants saw a growing risk of late payments and bad debts, indicated the survey, which canvassed almost 3,000 UK companies involved in the export business. "The 'it will never happen to me' syndrome continues to prevail among so many exporting companies," notes Richard Talboys, Executive Director Willis Ltd, Financial Solutions, Political & Trade Credit Risks.

"Others think the product too expensive, or that it covers only the good risks, or take the view that they can afford group losses at group level, if not at local level," he says.

Attentiveness to risk is beginning to grow, at least at the multinational company level, according to brokers. “At Aon, we have recently seen the awareness of geo-political risks among clients increasing sharply, to the highest it has been in 20 years at the senior management and board level,” underlines Stuart Lawson, Managing Director of Aon Trade Credit UK. “A number of our multinational clients, with the support of the Aon service teams, are pro-actively reviewing their current exposures to not only Russia and the Middle East but to all markets around the globe, and want to know far more about the risks that they are running and the quality of their cover. Moreover, new clients are looking more widely at their supply chain and investment risks.”

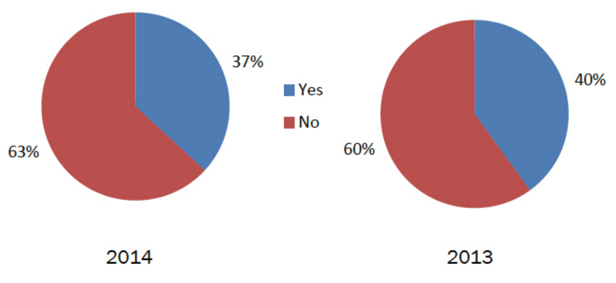
One issue that should be on the scanner of all trading companies is the swathe of so-called ‘zombie firms’ that have stayed in business only by dint of record low interest rates, argues Talboys.

“Insurers tell us these companies are everywhere around the world, and many will struggle for resources and eventually fail when interest rates rise steadily in the years ahead, or when banks can crystallise losses."

Insight and innovation

Global macro- and micro-trends call for credit protection as an essential trading tool, but the AIG survey suggested that the TCI industry has its work cut out. Only 37% of respondents purchased TCI products in 2014, down from 40% in 2013; and 53% in 2012.

Do you use Credit insurance?



International Trade Survey 2014

To reverse this pattern, better promotion of TCI is critical, urges Talboys. “First, the marketing side has to seriously differentiate our industry from the events of 2007-09, when some buyer limits were cancelled very ruthlessly, and then to highlight the growing level of innovation.”

Talboys underscores that TCI marketing “must engage holistically across the whole credit management space, helping companies improve the way they view and manage credit risk, rather than just doing it for them, which simply creates dependency”. This is necessary to challenge both the traditional image of TCI and the self-insurance model deployed as a trade credit risk mitigation technique by many companies. “Managers responsible for buying insurance know about property and casualty but often don’t know about the moveable feast that is trading risk, or that credit insurance is not just a commodity but a highly effective management tool to help companies avoid taking on other companies’ risks, and thus minimise bad debt. Non-cancellable with high deductible policies are a good call in this respect, as they address chronic past flaws in the product, by encouraging good credit management and responsibility for customer risk, thus aligning the interests of seller and insurer. The other key point is that the technology has evolved enormously, giving client management deeper insights into their balances and exposures.”

Lawson agrees that “we should focus more on articulating the benefits that TCI can offer, not only in respect of risk protection but also credit management support and trade finance.” He comments: “In depth analysis to identify and quantify credit and political risks before the product is “sold” and more tailored solutions will drive growth in the TCI market. It continues to amaze me how many companies make a decision to not protect its debtor asset without knowing the true inherent credit risk within its customer base.”

AIG’s Clark emphasises that the TCI industry’s evolved technology, its revitalised approach to information sharing and more tailored policy structures can be of equal use to the banking industry, as it seeks to deleverage balance sheet risk and align with Basel 3. Summarising, he cites a more positive response than prior to 2008. “There is a more holistic approach at work where it’s not just about banks or businesses seeking cover when the economy tanks, but widening that to understand the banks’ and clients’ medium-term plans and help them to grow. 2008 was a tipping point, prodding all the stakeholders within the industry into changes that will begin to win back customers.”

The International Trade Survey 2014 was sponsored by AIG, supported by The Institute of Export and undertaken by Trade & Export Finance Limited. Just under 3,000 UK-based companies, with turnover from less than a million to more than £100m, were canvassed, to investigate the current issues that have an impact on the ability of exporters and importers to trade in global markets.