

Credit insurance Q&A

Paul Rowland, director of Invictus Risk Solutions LLP, provides a summary of the results from the question-and-answer sessions he has conducted with clients and partners during 2015 in an effort to address how trade credit insurance operates on a granular level in the UK and beyond

The UK has proven itself to be a remarkably robust nation given its early exit from the financial diaspora that still besets swathes of Europe; Greece appears ever closer to defaulting for a third and fourth time while Italy, Portugal and Spain continue to battle very hard not to join her.

The über-expansionist monetary policy devised and executed by the Bank of England from the middle of 2012 to the present has successfully attacked the blues by injecting £375bn into the UK economy. This vast swathe of cash has been employed to counter soaring debt, soften the impact of a drop in exports and to balance the importance of the overdeveloped financial sector and thus restore confidence to households and companies.

While all of this has been happening the Open University Business School's enterprise research team has recorded that more than a third of the UK's corporates are exporters, generating up to 25% of their total sales via overseas customers.

Many companies are struggling to make ends meet while trading in the continuing volatile global environment. Given the continued crisis in confidence, a trade credit and political risk insurance policy can play a very positive part in securing a safe haven in which to operate.

How are UK corporates reacting to the need for additional sales?

Competition is increasing as UK corporates seek to maintain or win new contracts at home and overseas, looking to secure the financial wherewithal to survive in the current economic climate. The pressure on companies whose sales ledger is dominated by a single account



Paul Rowland

is enormous, and could lead to an inevitable loss of jobs and business closures if that account is lost or fails on its payments.

Is fast payment of outstanding invoices and debt still an area of concern?

UK corporates are clearly at risk when extending credit to new domestic or export customers and thus need to implement a prudent and watertight credit control procedure to survive.

With tighter accounting and corporate compliance responsibilities, most UK corporates engage credit vetting procedures into their standard credit management practices with all the benefits that this brings.

Those that do not face certain losses and an uncertain future vis-à-vis their own survival as difficulties with debtors or international socio-economic events take them by surprise.

Is there a positive image of the trade credit insurance underwriters?

A well-designed trade credit insurance policy, in combination with a proactive credit control policy, can help UK corporates to avoid late payments, increase sales and meet claims.

This message is certainly out there, but it can often fall upon deaf ears as the UK corporate environment has heard it all before from the industry and has a long memory of failed claims and bad press articles.

I suppose the attractiveness of trade credit insurance could be enhanced by making prospects and clients realise that it is no longer a simple assessment and placement of a standard policy product. A portfolio of assorted risk management applications and proprietary online systems can be engaged to solve domestic and export financial problems through the delivery of a high quality and real time service to UK corporates.

Even as other service industries come on stream, the UK has lost many of its specialist engineering and textile capabilities to cheaper overseas imports. Accordingly, entire stratas of insureds have been lost to the trade credit industry. While underwriters like to suggest that there has been an increase in the number of policy holders, there has actually been no demonstrative increase in the premium due to the competitiveness of pricing and the adoption of policy structures that increase risk retention for a significantly lower premium.

What turns a UK corporate off from trade credit insurance?

There are four key issues to address, as follows:

1. Additional administrative burden

There is a negative perception of the additional administrative burden, but a specialist trade credit insurance broker is able to provide advice, guidance and even sources of credit control documents and procedures that a company can engage to enhance their credit control rather than hinder it.

2. Threat to capabilities

There can often be a negative reaction from a financial controller or a financial director who feels threatened by their company's pursuit of trade credit insurance and the implied – incorrect – threat to their own capabilities and professionalism.

A UK corporate will insure its property and the lives of its directors but not necessarily its receivables that may account for more than 40% of the company's value and is in essence its very lifeblood. I would suggest that a thorough risk analysis supported by a proactive broker would be able to demonstrate the benefit to be gained from the promotion of risk avoidance and having an underwriter offer them a more informed position through access to the financial history and creditworthiness of their sales ledger.

3. Cost

The cost of a trade credit insurance facility will always be infinitely less than the cost to a UK corporate and its bank of having to fund a single or series of debts. This becomes particularly important where lower profit margins require a hugely increased flow of sales to replace the lost income and net profit.

4. Choice

There was an unprecedented level of acquisitions in the UK and European trade credit insurance market circa 10 years ago, and five years ago this led to three groups emerging to dominate the global market; Atradius, Coface and Euler Hermes. However, a second platform of high-profile underwriters such as ACE, AIG, Markel and QBE are winning significant market share.

The market offers three clearly defined disciplines of domestic, export and political risk. Because the trading platforms of most firms have become far more international, the differentiation between these disciplines has disappeared and a hybrid of all three can now be offered within the same policy structure.

“ The pressure on companies whose sales ledger is dominated by a single account is enormous ”

What impact do you think the proposed rising interest rates will have?

I would suggest that the predicted rise in inflation and taxes, the continued financial and political ramifications of overgenerous public sector payment/pension agreements, and the fall in the value and volume of order books will continue to bite into the UK's corporate and national competitiveness and profitability.

What can be done to counter large buyers squeezing suppliers?

It is a sad fact of life for any company that increased competition may drive down their negotiating strengths. To escape from this invidious position is easier said than done, but I would advocate that any UK corporate concerned with this aspect of their business should engage a specialist trade credit insurance broker and underwriter to evaluate the necessary financial information to determine whether they need to retain or withdraw from an existing contract.

The goal of this project would be to isolate a UK corporate from a trading position of extended terms of payment and reducing profit margins while tackling increased raw material purchase and manufacturing costs. Against these events we would seek to support the expansion of their sales network and replace lost revenue by successfully opening up new lines of supply into alternative buyers and markets.

How do underwriters engage with their clients' credit control?

The success of any trade credit insurance policy is based on the underwriter's ability to match and manage the value of the cover being sought. This comes in the form of an insured credit limit agreed by the underwriter against a specific buyer in conjunction with agreed terms of payment such as 30 days from date of invoice.

Through the inception of a policy, the risk underwriter is seeking to replace an ad hoc and potentially catastrophic method of vetting a buyer through accounts or status agency reports. In the rapidly-moving and volatile trading environment, this method is too archaic and one-dimensional to provide any mid-to-long-term worth. Accordingly, underwriters seek a more methodical process that involves a multilayered analysis through the collection and assessment of audited accounts; trading experience, market position of the buyer, etc.

“ The optimum new business opportunity is one where a firm has insurable turnover of £10m to £75m ”

This process creates a picture in the risk underwriter's mind of the real time and future creditworthiness of the buyer and the value of cover they will be afforded. The process is ultimately the same regardless of the size of the buyer but, clearly, a small family-run timber merchant in the West Midlands will require less aggregate cover across multiple policyholders in comparison to a major supermarket chain.

When and why do risk underwriters reject a request for cover?

Risk underwriters will refuse cover in the face of overwhelmingly adverse information – public or private and confidential – or where overdue accounts have been reported to them via other clients. If the creditworthiness of a company deteriorates, underwriters will seek to reduce or cancel cover; in the past, this took the form of a draconian and often immediate withdrawal. However, the negative commercial impact of doing this has led to closer co-operation between underwriter, broker and client to enable a smoother withdrawal, time permitting, or the provision of non-cancellable covers for the life of the policy where the creditworthiness allows.

What segment of the UK economy is attractive to trade credit insurance underwriters?

I would say that the optimum new business opportunity is one where a firm has insurable turnover of £10m to £75m, as this offers both the client and the underwriter the best opportunity to prove different levels of protection and premium. A selective quality of risk, and thus a positive premium-to-loss ratio in the underwriter's favour, is more important than volume accumulated at a discounted price with a subsequent poor claims performance.

In the past, some underwriters have been seen to buy in business through lower rates or becoming very focused on a small number of

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trade sectors. However, as reinsurers become stricter on the capacity they will release to the industry, more care is being taken with the selection process as a broader spread of risk by size and industry trade sector is sought. Some underwriters now boast of immediately declining one third of all enquiries upon receipt and initial assessment as evidence of their inquisitorial approach to new business.

What assessment do underwriters carry out before they will place a risk?

All new business market reviews will require the completion of a proposal form that seeks confirmation of the prospect's standard terms of payment; of any extended terms of payment; of who holds specific responsibility for the overall credit control system; of whether the credit control function is centralised; of how new accounts are vetted and authorised; and of the basis on which accounts are opened such as financial status agency reports, audited/management accounts, trading experience, personal visits, etc. In addition, underwriters will want to know how often information is updated and on what basis, and what standard course of action is pursued in the event that a buyer defaults on a payment.

With a low pick-up, how can the industry raise its profile and encourage a higher engagement?

Given the historical problems that have bedevilled a larger number of UK and global corporates, there has been no new cover written for many years. Even so, where cover cannot be secured, financial information can be sourced and evaluated vis-à-vis the target company's predicament and thus presented to evidence an overwhelming argument of a need to withdraw from a contract. By heeding such advice, companies can be diverted away from the impact of lost profit, raw material purchase costs and work in progress costs.

A further illustration of how a trade credit insurance policy can positively impact a business is where suppliers are supported by a proactive broking/underwriting team and thus benefit from the promotion of risk avoidance by focusing their credit control upon problem accounts. The risk underwriters can offer an informed position through access to the financial history and creditworthiness of a troubled buyer. Accordingly, payment

solutions can be negotiated when the debtor hits cashflow problems to help the insured client trade out of their position. Alternatively, goods can be successfully collected through the execution of the strict retention of title clause in the client's terms and conditions.

Will a high-profile UK corporate collapse encourage others to purchase trade credit insurance?

With reference to incentivising companies, there are two schools of thought within our industry. Firstly, there are those that dare not whisper the name in their sales pitch for fear of being regarded as a vulture picking over the carcass. Alternatively I would use it as a real example of how, with the right broker and a correctly placed trade credit insurance policy, a company could secure their profit and cashflow liquidity protection.

“ Asia is where the money is, and this is where UK corporates should be focusing their efforts ”

What issues should UK corporates be most concerned about moving forward?

The influx of new member country partners to the EU means that there is a constant re-alignment of national and corporate wealth. Meanwhile, the global economy becomes increasingly threatened by North America's huge twin budget and trade deficit occasioned by her economy's lack of immunity from rising interest rates and the fluctuating price of oil.

China and India's economic expansion is set to continue to rise, not at the 10% levels seen at the turn of the century, but certainly three or four times quicker than the UK and Europe. This means that these two countries alone will make a larger contribution to global growth and financial wellbeing than the combined efforts of the EU economy.

European and North American financial clout is waning against a climate of financial volatility, with UK corporates suffering an endemic trend of liquidity problems; whether they trade domestically or internationally, UK corporates continue to suffer from a weakened trading position as they seek to survive against

the burden of successive financial upheavals.

A sobering prediction is that some areas of the UK economy may be pushed into an avoidable but ultimately ruinous recession given external pressures. While they cannot control these events, companies can review and monitor their credit control procedures and reappraise the quality of their order book to ensure contract certainty and payment.

Where should UK corporates be looking to trade, and is the trade credit insurance industry able to support this?

The UK economy has proven itself to be pretty durable in comparison to some of its more parlous European neighbours, due to its own robust domestic demand and an ability to maintain a healthy export into the eurozone, which remains its biggest trading partner. However, in the words of Bob Dylan: "The times they are a'changing."

Given the continued growth of the Sino-Asian economies, and the surging consumer appetite within this region, it is clear that UK corporates should be looking in this direction. An HSBC study recently concluded that UK sales to China are set to grow fivefold over the next 15 years, and fourfold to India during the same period. Another survey carried out last year by research firm Wealth-X and UBS identified Asia as creating more wealth more quickly than any other part of the world.

Asia is where the money is, and this is where UK corporates should be focusing their efforts and talents, particularly as many underwriters now offer easily navigable online systems to administer their policy and/or local representation vis-a-vis buyer risk underwriting, collections and claims support. Accordingly, the effectiveness and management of trade credit insurance, even if held domestically in the UK, can be operated at arms' length efficiently and smoothly to project security into the other side of the world.

The UK and global business community has had to withstand the impact of Asian growth, the North American recession, a European economic stagnation, the troubles across the Middle East and the spectre of conflict with an increasingly belligerent Russia that has all the hallmarks of creating a crippling disruption of the west's energy supply and consequent fear around rising energy prices.

Despite the outward appearance of Europe enjoying a continued and strong economic recovery, the reality is that the

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stronger European and Nordic countries are actually suffering a weakened trading position as they face a repeated assault on their capital reserves and political resolve as a consequence of having to support their weaker partners who continue to falter under the burden of socio-economic and political upheavals.

It is against this climate of financial volatility that 80% to 90% of domestic and

international trade continues to be conducted on an unprotected cash or short-term credit basis of less than two years, as more and more UK companies move towards extending credit terms to their customers whereby products and services are delivered with payment received 60 to 120 days later. The only protection to the continuation of trading against open credit terms during times of

volatility is a well-constructed trade credit insurance policy. The alternative is a possible wave of UK corporate failures triggered by a loss of confidence in Europe's equity markets and jittery corporate investors on Wall Street.

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