

# CREDIT CONTROL

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**Trade Credit and Political Risk Insurance**

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# Cover Feature



## Trade Credit and Political Risk Insurance

Many companies continue to struggle to make ends meet while trading in a volatile global environment. Given the continued crisis in confidence, Trade Credit & Political Risk Insurance can play a very positive part in securing a safe haven in which to operate. In this article, the author seeks to address the current and predicted trends within the economic global climate and seeks to address the obstacles that continue to prevent Trade Credit and Political Risk Insurance from being a “must have” product for UK Corporates.

### In LEGAL ASPECTS ...

#### Recording and Transcription – Avoiding the Disciplinary Pitfalls

*The number of employers who are using digital recordings in disciplinary interviews, performance reviews, and interviews etc is growing. Offering an audio record of any interview, within minutes of its conclusion, helps avoid any accusations an organization may have acted inappropriately. If a case proceeds to tribunal, failure to keep accurate records of any interviews or hearings can cause problems at an appeal stage, but offering an accurate transcription of any interview with a certificate of accurate representation will significantly reduce any assertion that accurate records were not kept.*

# Analysis

## Trade Credit and Political Risk Insurance

Paul Rowland



**Paul Rowland**  
Oval Insurance Broking

### **Biography**

*During 20 years broking and underwriting on behalf of some of the industry's leading practitioners, Paul Christopher Rowland BA (Hons) has gained extensive experience in reviewing and placing a diverse range of transactions on behalf of UK and International Corporate clients to manage their Commercial, Financial, Liability, Trade Credit, Political Risk, Surety and receivables management programmes through the Lloyd's of London and Corporate insurance markets.*

*Paul has regularly written for Business Money, **CREDIT CONTROL JOURNAL** and **ASSET & RISK REVIEW** and has contributed to the Insurance Times and Post Weekly.*

*Email Paul at [paul.rowland@theovalgroup.com](mailto:paul.rowland@theovalgroup.com), or telephone direct +44(0)207 422 0146 (Mobile: + 44 (0)7666 86565). Oval Insurance Broking Limited office, Osborn House, 80 Middlesex Street, London, E1, 7EZ [www.theovalgroup.com](http://www.theovalgroup.com)*

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### **Abstract**

*Many companies continue to struggle to make ends meet while trading in a volatile global environment. Given the continued crisis in confidence, Trade Credit & Political Risk Insurance can play a very positive part in securing a safe haven in which to operate. In this article, the author seeks to address the current and predicted trends within the economic global climate and seeks to address the obstacles that continue to prevent Trade Credit and Political Risk Insurance from being a "must have" product for UK Corporates.*

### **Introduction – a personal story**

During my younger days in the City of London I was never happier than when at Boisdales of Bishopsgate knee deep in full bodied Rioja, gorgeous steak, big fat cigars and pretty girls. There has been a firm abstinence of the latter since my courting and subsequent marriage in 2000 to a wonderfully dynamic and robust Danish girl!

An invitation recently arrived to return to this most favourite of watering holes from one of my Friends who is one of the new breed of Bankers whose employer

is beginning to snap at the heels of the more established but heavily beleaguered Banking institutions.

So it was that we met for a couple of bottles of Spanish red velvet and soon found ourselves reminiscing about a particularly lively birthday party at my home during which my Father told him that he was a nice enough boy but God had only given him enough of a brain to comfortably fit in an aspirin bottle with just enough intelligence to open his mouth when he wanted to eat or drink but certainly nothing more; my Friend is now a leading Compliance Officer for an internationally recognized Bank! My Father's jovial admonishments did not stop there as he turned his steely gaze upon yours truly and commented that if all other sources of income failed, I could make a good living calling the dairy cattle home across the meadows of our beloved village of Chedzoy on the Somerset levels ... clearly no longer an option I am afraid given the devastation wrought by the recent flooding.

Skip forward two decades and as the cheese appeared with the fortified wine I started to make some pretty barbed comments about the performance of the Banking fraternity that broadly went along the line of "the reason why the UK and global economy is in the mess it is in, compounded by our previous Governments' disastrous sale of the nation's gold reserves and frivolous wastage of our actual and future credit, is that the Banks have constantly pursued a policy of indulgently viewing most financial projects, no matter how fishy their provenance, parlous their due diligence or lacking the security of insurance, with real positivity so long as they could see a bit in it for themselves!"

I referred my distinguished Friend to the much lauded financial journalist Anthony Hilton who had penned an article in the *Evening Standard* on Wednesday 5<sup>th</sup> June 2013 in which he stated "when a Chief Executive asks a question about risk, the answer he wants to hear is that he does not need to worry because his company is insured."

As I commented that the Banks had operated in a bold, cold and ruthless manner drinking the cup of greed to its dregs but always ready to fill it up again and have another go! I could see by the way he was beginning to gnash his teeth that my Friend was not taking too kindly to the criticism; a continuation was likely to lead to me being punched squarely on the nose which would to my mind have been a serious breach of the laws governing hospitality!

We sought to settle our differences by keeping the decanter circulating and returning home in the early hours I finally managed to collapse into bed as it swam past me the third or fourth time. Later that day, I was not at the peak of my form, there was a dark metallic taste in my mouth and a general disinclination for any kind of action or thought. The birds were singing loudly and I wished that they would not. Such was my disheveled state that an

undertaker passing me by would have sensed imminent business and a vulture an easy meal.

### **The European Economy**

The UK and Global business community has had to withstand the impact on its economy of the Asian crisis, the North American recession, a European economic stagnation, the impact of the troubles across the Middle East and now face the spectre of conflict with a belligerent Russia that has all the hallmarks of creating a crippling disruption of the West's energy supply and consequent fear around rising prices.

In view of the above, it is my belief that the current confidence of European businessmen, central bankers and investors is presenting a false perception of the reality of the trading conditions that they face.

The perception is that Europe is enjoying a continued and strong economic recovery while North America has survived the rising interest rates and the soaring price of oil. However, the stronger European and Nordic countries are actually suffering a weakened trading position as they face a repeated assault of having to support their weaker partners who continue to falter under the burden of their socio - economic and political upheavals.

Europe remains in the shadow of China and India whose economic expansion continue to rise at a level that means their progress has made a bigger contribution to global growth in the past 12 months than the combined efforts of the European Union economies.

It can be argued that the austere fiscal policies imposed by the Federal Reserve Board, such as the cutting of interest rates to revive consumer demands and protect their domestic market, are the major factor behind the North American economy beginning to rise from its painful experience of a housing market collapse, a realistic realignment of commodity prices and the uber competitiveness of emerging markets.

Europe's recovery continues to be hampered by North America looking inward to deal with its twin budget and trade deficit. At the same time, the continued influx of new member country partners into the EU, while meeting the Eutopian ideals of those EU bureaucrats dripping with high principles, actually means that there is a constant and destructive re-alignment of sovereign and corporate wealth within the existing EU family.

It can be argued that there is an over optimistic view of ebullient stock markets and commodity prices. Accordingly, the European Central Bank needs to engage a sober economic policy to prevent the European community from falling back into an unnecessary and ultimately avoidable recession.

It is against this climate of financial volatility that 80%-90% of world trade continues to be conducted on an unprotected cash or short-term credit basis of less than two years; more and more European based companies move towards extending credit terms to their customers whereby products and services are delivered with payment received 60–120 days later. The continuation of trading against open credit terms comes at the same time of volatility in Europe's leading equity markets occasioned by jittery corporate investors on Wall Street.

Europe's revival remains very firmly linked to North America's recovery and both are locked in a powerful embrace that cannot be unglued. Accordingly, the much quoted chaos theory of schoolboy economics: "When America sneezes, Europe catches a cold!" remains as true today as it did when the phrase originated back in 1929 during the aftermath of the Wall Street crash.

### **The European Trade Credit Insurance Market**

The European Trade Credit Insurance market remains the largest in the world with an approximate annual premium income of £2 billion. Our market is the most sophisticated and saturated with a very high level of penetration and we currently estimate that circa 90% of the world's policies by value of premium and volume of active policies is domiciled in Europe.

The European countries with the greatest use of Trade Credit Insurance based upon premium income as a % of GDP are Belgium and Holland. Other countries with a relatively high usage include France, Germany, Portugal, Spain and the UK.

There has been an unprecedented level of acquisition in the Trade Credit Insurance underwriting market in the last decade leading to the establishment of three groups who dominate through aggressive consolidation; Atradius, Coface and Euler Hermes. However, other high profile underwriters, such as ACE, AIG, Markel and QBE, are beginning to win market share at a time when the Trade Credit Insurance market seeks to harden its soft pricing position to validate the available reinsurance and increased competition.

The European Trade Credit Insurance market used to offer three clearly defined and different disciplines of cover; domestic, export and political risk. However, because most trading platforms 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 essence of Trade Credit Insurance**

On the back of an increase in project financing I believe that there will be an upsurge of interest in Trade Credit Insurance whereby underwriters offer an indemnity against a company's receivables. Accordingly, the money owed to the insured company is protected against non-payment or late payment of the insured debtor.

Trade Credit Insurance is not just about the assessment and placement of a standard policy product.

It is rapidly becoming a far more risk analytical discipline whereby innovative brokers are able to engage clients with a number of complex financial and receivables management tools. For example, Trade Credit Insurance is now able to underpin captives, financial packages such as bank loans, overdrafts and invoice discounting, debt collection, economic and country reports, credit information and creditworthiness reports on existing and potential clients.

The prevalence of internet driven on-line systems is enabling clients to access high quality and up to date information in real time. Accordingly, the larger underwriters within the industry have engaged their office locations and proprietary information technology to offer an “all seeing” umbrella of services to companies operating in the UK and abroad.

Imagine how a master criminal would feel having committed some ghastly and pre-planned crime of passion to find that in the living room with Colonel Mustard was Hercule Poirot, Sherlock Holmes and Doctor Who!

It is clear from the above that by becoming a complimentary mechanism to captives, discounting and forfeiting, the product is now more able to provide a form of guarantee in complex financial deals with underwriters able to bind cover against **four** distinct policy types and for **nine** positive reasons as follows:

1. Whole turnover policy that offers protection against the entire sales ledger of the insured.
2. Specific Account that offers protection against a single buyer and usually the insured's dominant trading partner.
3. Top Account which offers protection against the largest five to ten buyers who are usually the insured's dominant trading partners.
4. Catastrophe policy that offers excess of loss protection via a layer of indemnity above a sizeable deductible.
5. Of all the business pressures UK Corporates face, liquidity and ever lengthening credit cycles are the ones that concern them; disaster can strike virtually overnight and the business uncertainties faced since 2009 only serve to underline how quickly financial fragility can create real vulnerability.
6. Account receivables may make up more than 40% of current assets as seen on a corporate balance sheet and under corporate management these account receivables have to be cashed without fail. Overseas

recoveries, in the face of bankruptcy and insolvency, are much more difficult due to language barriers, different business customs, local legal systems or other factors.

7. Trade Credit Insurance can be engaged as a vital weapon to mitigate the unexpected and potentially disastrous hits that come with creditor bad debt and to protect the balance sheet against customers going under while owing money.
8. UK Corporates should be able to evidence the huge value of the promotion of risk avoidance by focusing credit control upon problem accounts through a Trade Credit Insurance online system that provides “real time” credit information such as change in financial conditions or signs of business declining by regular credit monitoring.
9. There is a huge value of being able to access the financial history and credit worthiness of potential buyers to provide a more informed position when making commercial decisions to promote sales growth.
10. If there is a very robust credit management in place it will be further enhanced with cash flow improved and “days sales” outstanding reduced while enhanced terms of payment may be offered to secure continuity of business.
11. Borrowings and other lines of finance will be made more accessible/cheaper due to increased security.
12. A Trade Credit Insurance underwriter can provide a collection service with lawyers and agencies at the time of protracted default therefore the UK Corporate’s treasury resources and debt reserves can be reduced; at times like this when you are having a scrap with a debtor, the rule of thumb is that when your antagonist falls to the ground you do not wait for anyone to count to ten but kick them in the slats!
13. Payment solutions can be negotiated to trade a debtor with cash flow problems out of its financial difficulties.

### **Stringent Underwriter Market Review**

Gone are the days of an underwriting claims manager looking like a benevolent Godfather, patting a client on the head with one hand while writing a fat cheque with the other.

Notwithstanding the constant desire to drive down premium spends, the success of any Trade Credit Insurance policy is 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 adhoc 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 multi-layered analysis through the collection and assessment of audited accounts; trading experience, market position of the buyer and face-to-face visits, etc. 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 it will be afforded.

The process is ultimately the same regardless of the size of the buyer but clearly a small engineering company in the West Midlands will require less aggregate cover across multiple policyholders than Tesco's.

Underwriters will cancel or refuse cover in the face of overwhelmingly adverse information, where overdue accounts have been reported or the creditworthiness deteriorates. In the past, this took the form of a draconian withdrawal but the commercial negative impact of doing this has led to closer co-operation between underwriter, broker and client to enable a smoother withdrawal, time permitting.

In the past, some underwriters have been guilty of buying in business through lower rates or becoming too focused upon a small number of 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.

The lesson learnt is that 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; this has led to some underwriters boast of declining two in three of all enquiries as evidence of their inquisitorial approach to new business.

### **Political Risk**

As a UK Corporate expands its network to overseas it will be exposed to the potential risks of loss under political events and various negative influences in certain countries. Accordingly, a Trade Credit Insurance policy can be "extended" to provide Political Risk coverage for actual losses caused by "confiscation", "expropriation" and "nationalization" – CEN:

- Investments that cannot be recovered;
- Sales stocks, account receivables and other current assets;

- Business shutdown;
- Cancellation of business collaboration or contract with a local entity by business interruption;
- Repatriation of Dividends;
- Business Interruption;
- War Clause;
- Sabotage;
- SRCC – Strikes, Riots & Civil Commotions;
- License Cancellation.

### **Future opportunities and risks**

There remain a huge number of trading opportunities in China, India, Japan, Russia and the Middle East as their economies race ahead of Europe on the back of direct Sovereign support, aggressive expansion programmes, booming commodity and oil and mineral revenues. There is also great potential across Latin America and Sub-Saharan Africa as both regions continue to enjoy their best economic performance for 30 years.

Notwithstanding the above, one can still hear the hoof beats of the economic horsemen of the apocalypse as the inherent financial problems these regions experience means that growth cannot be sustained unless exporters are protected from the huge threat to their balance sheets through debtor non-payment and insolvency; these risks increase when trading with developing countries, not only in times of buoyancy and recession but also in the recovery period. Nothing introduces a sour note into an economic recovery than the abrupt disappearance of confidence in a puff of smoke.

In addition, I would suggest that as yet unresolved conflagrations of the Middle East and the Ukraine need to come with a stark warning that the subsequent change in oil and other commodity prices will pose a serious risk to both economic growth and inflation across the world.

It is against this climate of financial volatility that UK companies continue to suffer an endemic trend of liquidity problems.

Whether they trade domestically or internationally, UK companies may suffer from a weakened trading position and may begin to falter and collapse under the burden of successive financial upheavals.

A sobering prediction is that some areas of the UK economy may yet be pushed into an avoidable but ultimately ruinous position.

Part of the solution is to implement, monitor and review prudent and watertight credit control procedures while they reappraise the quality of their order book to ensure contract certainty and payment.

### **What are the obstacles to embracing Trade Credit Insurance?**

The most pertinent question is whether UK corporate fully appreciate the credit risks they face when pursuing business?

Market opportunities are shrinking and competition is increasing as businesses seek to maintain or win new contracts at home and overseas with most senior management doing so with their eyes wide open. However, the pressure on a sales ledger that is dominated by a single account is enormous and the loss of this account would remove the businesses' financial wherewithal to survive in the current economic climate leading to an inevitable loss of jobs and business closure.

In addition, the predicted rise in inflation and taxes, the financial and political ramifications of an over generous public sector payment/pension agreements and a fall in the value and volume of order books, will continue to into the UK's corporate and national competitiveness and profitability.

All businesses recognise that they are 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. Those that do not, face losses and an uncertain future as they seek to react to economic and trading events that take them by surprise.

In life, it is not the fight that matters but the courage which one brings to them. Accordingly, the solution is for businesses to invest in tighter accounting and corporate compliance protocols and to also benefit from the additional layer of protection and value that a Trade Credit Insurance policy (assessed, negotiated and placed by a specialist broker) can inject into their standard credit management practices with all the benefits that this brings.

In view of the above, what are the issues that businesses consider a "turn off" and prevents them from embracing Trade Credit Insurance and how can they be persuaded about the benefits?

There are **four** key obstacles to overcome but these are mindset issues that can be calmed as follows:

#### **1. Cost and poor value for money**

The central theme of our encouragement is that the cost of a Trade Credit Insurance facility will always be infinitely less than the impact of a significant

loss, or series of losses, where a business has to “finance” the debt against a low profit margin and increased sales to replace the income.

## **2. Administrative burden**

As with all insurance there is a certain amount of work that the applicant must complete for a Trade Credit Insurance review to be successful:

- A completed proposal form;
- Confirmation of the applicant’s standard and extended terms of payment;
- Confirmation of who holds specific responsibility for the overall credit control system;
- Confirmation of whether the credit control function is centralized;
- Confirmation of how new accounts are vetted and authorized;
- Evidence of on what basis are accounts opened such as financial status agency reports, audited/management accounts, trading experience, personal visits.

In addition, underwriters will want to know how often information is updated, on what basis, and in the event that a buyer defaults on a payment, what standard course of action is pursued.

Once a policy is in place, we would argue that a specialist Trade Credit Insurance broker should be able to provide advice and guidance and even examples of credit control documents and activities that a company can engage to administratively enhance their credit control, not hinder it.

In addition, all underwriters offer easily navigable on-line system to administer their policy coupled with strong collections and claims support; the key is to ensure that the management of the policy is as smooth and unobtrusive as possible.

## **3. Staff feel threatened by the product as it may imply criticism of their capabilities and professionalism**

Our argument is that all businesses insure their properties and the well being of their staff but not their receivables that can account for more than 40% of the company’s value and is therefore its very lifeblood.

## **4. Loss of Industry**

There has always been an historical take up of Trade Credit Insurance through specific UK industry trade sectors such as Construction, Engineering, Manufacturing, Marketing, Steel, Textiles and Timber. Unfortunately, even as

other service industries come on stream, the UK has lost much of its specialist Engineering, Manufacturing, Steel and Textile capabilities to cheaper overseas imports and entire industries have been lost.

Both here in the UK and overseas, Corporate giants are using their “muscle” to squeeze suppliers while ignoring the fact that they are suffering from the same tough trading conditions; they behave like Napoleon, they expect their orders to be carried out without a hitch and do not listen to excuses. This is a sad fact of life where competition drives down negotiating strengths and to escape from this invidious position is easier said than done. However, given that rather like boxing, the sharp right uppercut is certainly something that is better to deliver than to receive, we would advocate that a UK Corporate concerned with this aspect of their business engage us to source and evaluate the necessary financial information to present them with overwhelming evidence of their need to retain or withdraw from existing contracts.

If our advice is heeded, the UK Corporate may be able to isolate itself from an horrific trading position of extended terms of payment and reduced profit margins while tackling increased raw material purchase and manufacturing costs. We would seek to support them to expand their sales network and replace lost revenue by successfully opening up new lines of supply into alternative buyers and markets.

### **Conclusion**

Since 2009 the UK and Global economies have survived a catastrophic crash akin to the Albert Hall falling onto Kew Gardens that left us all in shock and facing a sobering financial environment.

My fervent belief is that we are on the road to recovery but no doubt upon reading this there are those of you who, if there is an aisle nearby, will roll in it giving the impression of a Hyena which has just heard a rip snorter of a joke from another Hyena! However, I stand by my conclusion which is born of a heady cocktail of natural optimism and an analysis of the economic moods and trends coupled with a steadfastly jingoistic faith in the UK’s ability to boost investor morale and rebuild industries, portfolios and services.

The effect of taking the decision to engage a Trade Credit Insurance policy is rather like kissing a beautiful girl who in the opening stages kicks you in the shin only to realise that she is beginning to feel disgracefully happy about it all!

The message is certainly “out there” that the combination of professional credit control and a well designed Trade Credit Insurance policy can not only avoid late payments but increase sales. However, this message can sometimes fall upon deaf ears as corporate senior management has heard it all before from the industry.

To get the message home from a broking perspective, we can engage our project finance partners with our Trade Credit Insurance products to generate an upsurge of interest from companies that operate both domestically and internationally; we can seek to evidence the attractiveness of the products by making prospects and clients realize that it is no longer a simple assessment and placement of a standard policy product but a portfolio of assorted risk management applications to solve any domestic or export financial problems through the delivery of a high quality and real time service to them.

The combination of a robust credit and treasury management and procedures with a properly structured Trade Credit Insurance and Political Risk policy will promote risk avoidance and provide a more informed position through access to the financial history and credit worthiness of the sales ledger. Accordingly, business protection, higher profit margins, an enhanced balance sheet and increase shareholder value will allow a UK Corporate to trade with more confidence, security and an energetic cash flow liquidity.

Given that international trade is expected to enjoy considerable growth, the ability of companies to trade safely and with confidence, for a premium, will increase exponentially. Accordingly, and despite the fact that Trade Credit & Political Risk insurance remains a non-mandatory purchase, it is our opinion that it will become “a must have” product for UK Corporates across the rest of this decade and beyond.

Oval Insurance Broking has built relationships with insurance markets that give us the edge over our competitors and in turn allow us to create a bespoke programme that works in harmony with the individuality of your risks.

We believe that one of our greatest attributes to success is our ability to build close relationships and become a perfect fit for our clients.

The alternative is not good; there is only one real cure for a further period of consistent corporate failure .... it was invented by a Frenchman, built by a German and laid waste to the flower of French Aristocracy and the new political elite that sought to replace them thereafter, it is called “Madame Guillotine.”