MAINTAINING TRADE CREDIT STABILITY IN AN AGE OF DISRUPTION

The credit (re)insurance market helps to provide a measure of corporate stability in an increasingly volatile and connected global trading environment. It is fair to say that trade credit finance oils the wheels of the global economy as it navigates to an increasingly uncertain destination.

In this white paper we outline the challenges and risks facing global corporates in today's fracturing geo-political environment. Brexit is a potential short term disruptor. Increasing immigration is leading for calls to introduce stringent border controls. Political risk, war and cyber terror are major boardroom concerns. Emerging technology meanwhile is a great opportunity as well as a risk to businesses with miss-aligned corporate strategies.

Who will be the winners and losers in today's volatile and "extremely connected" trade credit environment?

UK Trade Credit in 2015

Nearly £150m was paid out to UK businesses in insurance claims for customer insolvency or late payment last year, an increase of 42%. The latest annual ABI figures for trade credit insurance shows that 11,000 claims were made by businesses in 2015, an increase of 19% on the previous year. While total company insolvencies in the UK are at their lowest level since 1989, UK businesses continue to face risks with economic volatility in many export markets, and subdued UK growth across the manufacturing, construction and services sector.

ABI figures show that £149m was paid out to businesses, the equivalent of £3m a week, to support them when a trading partner did not pay them money owed. 11,000 claims were made by businesses on trade credit insurance policies. 74% of policies cover businesses trading domestically, 22% of policies cover businesses exporting goods abroad. More than 11,900 policies were sold by UK trade credit insurers.

Trade credit insurance remains an Imprtant tool for UK businesses in facilitating international trade, with the proportion of export polices rising to 22% in 2015, as companies of all sizes recognise how trade credit insurance can help manage the financial risks that can come with exporting. Source 1: ABI

Global Trade Credit

Trade credit insurance also remains an invaluable tool for international businesses according to the International Credit Insurance & Surety Association (ICISA) which has reported strong and stable figures over the last few years.

ICISA is optimistic about the year ahead, according to its ICISA Yearbook 2015/16. However, ongoing political unrest in parts of the world and the effects of sanctions on trade are risks members identify as potential threats to positive trade development. China and Brazil are underperforming. Political unrest, especially in the Middle-East and the refugee crisis in Europe make it a challenge to make predictions about the future of trade and industry.

The Association reports that trade credit insurance results continue to improve and now exceed pre-crisis levels (2007), with a 34.6% higher premium income and 29.1% higher insured exposure. Although premium income and insured exposures continue to grow, members are also experiencing a drop in average premium rates. The overall improved market situation for construction companies and the transportation sector is reflected in decreased surety claims figures. Comparing the 2014 surety results with those from before the crisis (2007), premium income has more than doubled, while the insured exposure grew by almost 85%.

Brexit Fears

The vote on whether Britain should leave the European Union is only a few weeks away. News editors around the world are sharpening their pens in anticipation of the outcome. Uncertainty over the potential impact of Brexit has already affected corporates.

45% of attendees at the Association of Corporate Treasurers (ACT) conference recently named volatility driven by uncertainty as the factor currently having the greatest impact on their business. Brexit is playing a significant part in that and it therefore comes as no surprise that the majority (85%) of the audience is in the "Stay" camp." Source 2: GT News

Robert Nijhout, Executive Director at the International Credit Insurance and Surety Association (ICISA), comments: "The prospect of Brexit is a huge uncertainty which is damaging market confidence. I can say for our ICISA members that they hope Brexit will not happen because our view is that it is detrimental to free trade. If it happens it will be anyone's guess what the implications will be but what matters to credit insurers is how easy will it be to trade? The moment barriers are thrown up is a potential risk.

"The Brexit risk is primarily with the exporters. Let's imagine a very large exporter - a Company X –in the FTSE100, for example. If Brexit happens and Donald Trump wins the U.S. Presidency there is a realistic scenario in which trade freezes because suppliers are nervous that Company X will not be selling as much. That means that credit insurers will likely bring the limits down, with increased risk for suppliers and also increased risk for Company X? The ability of Company X to trade could be impaired even though it is ostensibly a well-run, healthy company."

Migration Moves to Top of the Agenda

The world is on the move, literally. Immigration dominates the news agenda today. The number of international migrants worldwide has continued to grow rapidly over the past fifteen years reaching 244 million in 2015, up from 222 million in 2010 and 173 million in 2000. Nearly two thirds of all international migrants live in Europe (76 million) or Asia (75 million).

Northern America hosted the third largest number of international migrants (54 million), followed by Africa (21 million), Latin America and the Caribbean (9 million) and Oceania (8 million). In 2015, two thirds (67 per cent) of all international migrants were living in just twenty countries. The largest number of international migrants (47 million) resided in the United States of America, equal to about a fifth (19 per cent) of the world's total. Germany and the Russian Federation hosted the second and third largest numbers of migrants worldwide (12 million each), followed by Saudi Arabia (10 million).

In 2014, the total number of refugees in the world was estimated at 19.5 million. Turkey became the largest refugee-hosting country worldwide, with 1.6 million refugees, followed by Pakistan (1.5 million), Lebanon (1.2 million), and the Islamic Republic of Iran (1.0 million). More than half (53 per cent) of all refugees worldwide came from just three countries: the Syrian Arab Republic (3.9 million), Afghanistan (2.6 million), and Somalia (1.1 million). Source 3: UN International Migration Report 2015

Robert Nijhout says: "I have two points to make about the current migration of peoples from war torn zones and the impact on global trade credit. One is that the "knee-jerk" effect of closing borders has an impact not only on people but also on goods. For example, perishable goods: if it takes two days to cross a border you might as well throw perishable goods away.

"The same thing applies to Calais and what is happening there, a lot of goods and traffic are being stopped because of migrants who attempt to cross the border on heavy goods vehicles. Whatever your views of migration, for better or for worse, if it [increased border controls] hampers the movement of goods as far as ICISA is concerned that is a problem and risk to our members."

The World is flat!

Political and sectarian ideology is a more important factor in causing geo-political volatility, while technology is making the world more flat as well as more connected. At the same time, cultural and religious divides cause fracture points and friction across economies around the world.

Fracturing wealth, social mobility, and social cohesion allied with religion tensions are being played out in a grand narrative with implications for trade because these all too human drivers of change cut across each other.

The consequential effects of political risk on the global connected market extends to corporate exposures such as corruption. UK Prime Minister David Cameron recently talked about introducing a new corporate offence for executives who fail to prevent fraud or money laundering inside their companies. The prime minister revealed plans to require all foreign companies buying property in the UK to disclose their true owners in a public register for the first time.

By extending a corporate failure-to-prevent clause to fraud and money laundering, the government's intention is to go further than merely requiring firms to prevent bribery and tax evasion. Should an employee be charged with money laundering, the company will be deemed liable if it cannot show that it had put procedures in place to prevent money laundering and fraud. Source 4: The Guardian

Interconnectivity

Interconnectivity caused by fluid social media has also caused other politicians such as U.S. President Obama to comment on the difference between now and 30 years ago when there were three TV news channels compared to hundreds today. Being preached to by the converted is in some ways leading to a more polarised world.

Social media technology is empowering people to have their own views, which is not necessarily a negative on an individual democratic level but it has potentially negative implications at an aggregate geo political level. Governments have to nurture their electorates in a certain direction but people's views are more diverse and, often, entrenched.

What we're seeing is a natural consequence of more choice so more choice means more opinion, conflicts and difficulty in policy making, resulting ultimately in instability. According to President Obama "It is really a big challenge for the US. In the present era, the connectivity between politics and economy, and between internal and international affairs has reached an unprecedented state. The entanglement of partisan politics is not good for US prosperity."

Extreme Connectivity

Robert Nijhout says: “The challenge with social media driven change and the internet is that there is a widespread perception that what is reported online is the “truth,” but it is not always possible to understand when the information was posted - it could be news from 15 years ago which is now suddenly emerging because a topic is hot. It could be something from an old newspaper and people are always looking for something to confirm and validate their own held opinions.”

“The world of shopping is moving online. More and more people are buying fridges online rather than going down the high street and it is the same for TVs, books and other goods. I can’t remember the last time I bought an airplane ticket in a travel agent, can you? But we are now insuring the Ali Baba’s of this world for their credit risks, so the world is changing for credit insurers too,” says Nijhout.

“At our ICISA AGM in a few weeks’ time the theme of the age – cyber risk - will be our topic. At one of our recent meetings our invited cyber expert pointed out that if a major theft takes place in an organisation and 10 million data files are stolen it is an extremely bad day at the office but a return to something like Business As Usual is possible relatively quickly.

“The risk, however, is not merely confined to that single organisation. In a world of extreme connectivity we don’t truly understand what the consequences are because we are all connected with such companies in some way. Our identity may be stored in those stolen 10 million stolen files so our personal data could be used for ID fraud. I see this as the biggest potential disruptor and risk to global trade at the moment because the hackers appear to be miles ahead of all organisations and even Governments at the moment, which are finding it impossible to keep up.”

“Emerging online technology however, is not a systemic risk for retailers in general: it is just a question of changing to a different business model that understands different methods of distribution, and those that adapt do well.”

Corporate Failures

There have been a number of high street retail failures in recent years. Taking the UK as an example, we have viewed the demise of traditional chains such as HMV and British Homes Stores as an expression of customers’ preferring to transfer their allegiances to the world of online shopping, but it is not as simple as that.

Robert Nijhout says: “There may have been claims resulting from the recent BHS news story, I don’t know the details, but one thing I know for sure is that the BHS case would not have been an overnight event. In such cases you would be able to see what sort of investment has been pulled out of the company in the last couple of years. Often in such instances it’s not a matter of if but when.

“BHS is a good illustration of why organisations buy credit insurance. Yes it is the insurance risk to cover the exposures that business have but that is only 20 per cent of the reason. 80 per cent of the reason for buying credit insurance is the forward looking ability that ICISA’s insurance members have. We see payment behaviours. We see for BHS, for example, that it’s not just the largest suppliers at risk, we see it is almost everybody because they are probably all insured somewhere.

The Appeal of Credit Insurance

“If you are a global credit insurer like Euler Hermes, Coface or Atradius you see suppliers from all over the world supplying to BHS and if BHS starts to delay payment to one or two suppliers it is a red flag. If they start delaying across the board then we can start to say hey there is something up.

“The first thing credit insurers do is to visit the organisation in danger of dafault, we talk to them and try and find out what is going on and in a worst case scenario you might reduce limits or take limits out all-together, which of course is a last resort because such an action could speed up the demise of the company.

So credit insurers do have a forward thinking ability: they can see patterns and adjust accordingly. What they do with their policyholders is red flag the risk, your main buyer is BHS, for example, we expect that within x months there is going to be a big problem there, are you comfortable with that? Maybe you should be looking for buyers other than BHS. The bigger the policyholders the more often these meetings take place."

Why Credit Insurance Works

"I understand that companies like Selfridges, for example, are doing extremely well because they also offer a good internet option as well as an in-store option. People shop online for convenience and also come to the store for the experience. The conclusion is that retailers with a realistic strategy that understands how the public mood and its preferences are changing in whatever niche they fulfil - whether it is at the High Net Worth end or a discount provider – must align with their clients expectations."

The forward looking appeal of credit insurance was highlighted by a Daily Telegraph news story from the 26th April 2015, which reported at the time: "BHS has unveiled two new supplier relationships as it battles to reassure credit insurers about its future under new owners. The retailer, sold last month for £1 by high street tycoon Sir Philip Green, said it has agreed new contracts with Compass, the canteen operator, and cash and carry giant Booker.

This announcement came after The Sunday Telegraph at the time revealed that HMV's revival efforts had been dealt a blow after major suppliers had their credit insurance cover cut following its takeover by a consortium of financiers. What better way to illustrate the forward looking appeal of credit insurance products than by going back to the past to validate its predictions, an achievement to which the authors of this article owe thanks to the internet!

Systemic Risk

The fear persists, however, that systemic risk could be an internet driven risk with the potential to disrupt, possibly even destroy businesses, with a consequent knock-on effect for (re-)insurers.

According to Solvency II Wire: "Systemic risk can be defined as the result of a cascading process that unravels throughout a network structure. The empirical evidence of reported losses...suggests that today's insurance firms are becoming increasingly interconnected and that they appear to be embedded in the same network. As a result, systemic risk poses a real threat, as the failure of a single firm can affect all the other firms connected to it and thus have a disproportionate effect on the market as a whole.

"Specifically, we assume that firms with comparable admissible assets invest in assets with similar characteristics (e.g. volatility, risk etc.). It is therefore reasonable to assume that larger firms have the capacity to invest in higher-risk, higher-return assets and hence, are more likely to be linked. The interconnectedness, or "network", that insurers form is inferred through their exposure to similar assets. Insurers could also be related by virtue of having common reinsurance counterparties or major suppliers, for example."
Source 5: Solvency II Wire

The credit (re-)insurance market as a whole has played an extremely important and positive role helping to keep global trade ticking along during a fraught and often volatile period in the near decade post Lehman. During an age of austerity, astonishing technological advancement, political and cultural division and social unrest, credit insurers have played their part keeping trade on even keel. In particular, the product's forward looking predictive capability has been invaluable and will continue to provide reassurance to corporates in what is likely to be a challenging time for the global trade environment.

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