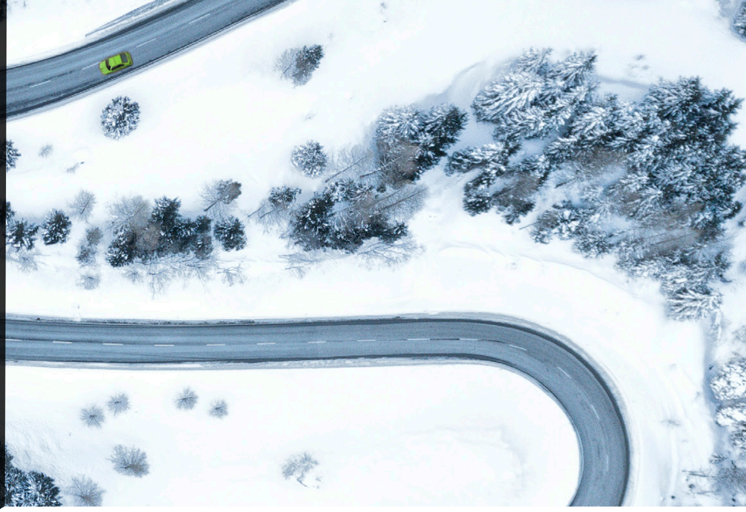
C-SUITE SERIES

CREDIT SOLUTIONS



COVID–19 impact on trade
The role of credit insurance

COVID–19 leaves businesses urgently looking for ways to weather the pandemic storm

According to IMF figures published in Aon's latest C Suite Series report on Credit Solutions – Driving growth through uncertain times – the global economy grew by just 3% during 2019, the lowest rate of growth since the recession of 2009, with further slowdown expected in 2020. This prediction, however, was made before the outbreak of COVID-19 which could well be the final trigger that will push the global economy into recession. One direct consequence could be a reassessment of the use of credit insurance by companies urgently seeking ways to maintain growth, protect their balance sheets from bad debt, while securing access to bank funding.

Already an economic and trade crisis

In 2019 we saw an increase in demand for credit and political risk insurance as companies looked to protect against payment default and banks utilised cover to lower the cost of working capital finance. Early 2020 had already seen social unrest and political tensions rising with insolvency trends up and uncertainties growing. The world is now awoken to the realities of a global pandemic. It is difficult to see which sectors will be unaffected; while the Services industries can function with employees working remotely, many other sectors require staff to be physically present. According to market estimates, COVID-19 global business disruption could create a reduction in trade of goods and services of around USD320bn per quarter, with insolvencies to rise further.

Clearly airlines and tourism are expected to be severely and primarily impacted, and to date, China, Italy and South Korea are already particularly suffering but the knock-on impact of COVID-19 related issues across industries and countries is still uncertain. Wuhan, the centre of the outbreak, manufactures steel, including a huge range of components for the automotive and technology industry across the globe. And without the draw of Chinese industrial production, cargo ships find the routes are uneconomic and are not calling at intermediate ports in the Asia and the Indian sub-continent, and this is having an impact on freight rates. At the beginning of the year the automotive industry In Europe and the US, was fretting about international sales, these concerns have now been transposed to production lines. As COVID-19 leads to lockdowns across countries, we can expect to see will see further impacts across more sectors.

Supply chain as key risk factor

Inevitably, there will be a standstill of the supply chain which will, in turn, cause a domino effect on the economic situation. If a company cannot produce because they have a lack of supplies and materials then they will have face significant operational and financial issues. Many companies are expected to experience a marked drop in turnover and revenue but, unless country governments intervene, they will still have to pay all their fixed costs such as employee wages and building/office rents. Many businesses operating on already tight margins do not have the balance sheets to handle a situation when they aren't producing. The consequences for many will be insolvency.

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Credit insurance reactions to immediate economic and trade downturn

If a global recession bites then there will be increased bankruptcies, with companies in certain sectors such as Travel and Leisure, Automotive, Textiles, ICT and Retail expected to be particularly threatened.

The credit insurance market is expecting a significant increase in payment defaults and insurers have started to implement plans to review and reduce their insured exposures in certain countries and (e.g. China and Italy) and trade sectors as above, particularly to reduce unutilised credit limit capacity to actual/current trading levels.

Clients should be able to rely on their broking advisor to implement a pro-active credit limit maintenance process to help ensure their insurance programmes weather these turbulent times. This should also include periodic calls with the head offices of key credit insurers to pro-actively monitor the situation as well as create a platform for appealing critical limits.

From a loss settlement perspective, the vast majority of credit insurance policy wordings do not mention pandemic as an excluded cause of loss. And, given that the causes of loss covered under any policy are non-payment, either as the result of insolvency, protracted default or political risk, insured clients should consider the following:

1. Insurers' expectation is that normal policy requirements apply, for instance non-payment cases are pursued and reported by the insured, in line with normal practice.
2. Claims will continue to be reviewed on an individual case basis and assessed on their individual merits.

Also importantly, insurers will need transparent information, especially around cash flow forecasts, to continue to write credit limits on businesses. To ensure availability of coverage for their suppliers, businesses should share updated business and financial information with credit insurers in the same way they would with lenders.

Reassuring lenders

Financing could also become an issue in the longer term as banks and financial institutions perceive some businesses as too vulnerable to lend to and become more selective. Aon's credit report highlights how banks have looked to "de-risk their own balance sheets" which has had a knock-on effect for businesses of being unable to secure credit. COVID-19 will only heighten that sense of banking caution and they will be looking for additional security when lending money, which is where credit insurance can play a larger role in terms of insuring a business's trade receivables, giving a bank more confidence.

Although the COVID-19 pandemic will come to a close at some point and global trade is expected to resume, its economic hangover is likely to be longer lasting. The positive news is that the credit insurance market has learned from previous financial crisis. Insurers now have access to better financial transparency on the credit risks covered with the data and analytics that they didn't possess ten years ago. This means they can offer the long term support businesses need not just to shore up their trade receivables in uncertain times but also to help them identify businesses they should partner with in the long-term, while also helping to improve their access to credit lines.

For more insights around Credits Solutions that support businesses , download a copy of Aon's latest C-Suite Series report Driving growth through uncertain times.

For more information around overall pandemic response, access Aon's COVID-19 Response Site.

About Aon

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