The trade credit risk vortex

Exporters are hard hit by high premiums and tough policy conditions including lower indemnity cover as global trade credit insurers tighten their watch on risk exposures.

BY YOKE HAR LEE

The financial credit crunch has taken its toll on the trade credit insurance market where premium costs have risen sharply and underwriters are scaling back on their risk exposures. The wool industry is one of the casualties as underwriters have all but stopped writing new business in this sector.

Trade credit insurers have also been hesitant to write new business for the auto, textile and apparel, retail, mining and building and construction industries, industry officials say.

Due to the sharp rise in demand for trade credit cover, the Export Credit Office has stepped up its role, and is exploring the concept of co-insuring with private insurers. The government is also considering increased funding for the ECO to help it cater to exporters' demand for trade credit protection.

Companies across the world are undertaking stringent internal assessments of their risk exposure and trade credit insurers are undergoing the same process. "What we are starting to see is a reduction in cover provided by the industry," says Mike Kayes, trade credit manager at QBE Insurance, a key Australasian trade credit insurance player. He confirmed that QBE has been reluctant to take on new business in the wool sector but this could change.

"In the past, if an insurer was happy to provide cover for $1 million in trade value, the company would probably be only willing to cover up to half of that value now. And if financials from the client are not up to date, they would probably say 'no'. Everybody is taking a more conservative approach in the underwriting of the credit risks," Kayes adds.

Atradius New Zealand's country manager Kevin Harris says most of the firm's cover is still in place and his firm continues to provide cover to troubled sectors. "There are several industries, including construction and mining for instance, that we are paying close

KEY TAKEAWAYS

- Be prepared for your trade credit insurers to get tough on you.
- Spend time helping your insurers understand the profile of your debtors
- Try the Export Credit Office if private insurers won't insure your trade
- Understand the Export Credit Office will only fund viable transactions
- Manage your risks well, chase up on clients slow in paying

attention to but we have not withdrawn from those industries.

"We have a long association with the wool industry and continue to cover it domestically and internationally. Having said that, it is one of the industries that has struggled in the downturn and we have been obliged to scrutinise and react to many credit limits that are not sustainable in the short term," Harris adds.

INDEMNITY DROPS

Exporters are definitely feeling the pinch as premiums for trade credit insurance have leapt by between 20 and 30% in the last 6 months.

Insurers are also putting the onus on clients to provide up-to-date financial information; are tightening policies to ensure payment terms are shorter; and reducing the amount they are prepared to provide cover for.

Indemnity levels – previously sitting near 90% – are being reduced and insurers are not likely to provide indemnity cover for over 85%.

The downward rating for Atradius to A- (from A rating, in March 2009), a global insurer based in Netherlands, has also left a gap in the New Zealand market. Market observers say Atradius has been the most aggressive in scaling down exposures in this part of the world after the parent company reported a net loss of EUR193.4 million for the 2008 financial year (2007: net profit of EUR164.2 million). QBE, Euler Hermes, Atradius and Coface are the key players in the New Zealand market.

Atradius' Kevin Harris says in response to this: "The opinion of the ratings agencies does not affect our underwriting position. Our decisions are made based on the data available on an individual buyer, the macro-economic environment and the country risk elements if it is an export deal."

Rodney Mathers of Trade Credit Bureau, based in Katikati, told *Exporter* that due to the tough conditions imposed by underwriters, exporters were caught in a tight situation. Cost of cover has "doubled" in some cases, he says, and exporters are struggling with the inability to find cover.

"IN THE PAST, IF AN INSURER WAS HAPPY TO PROVIDE COVER FOR $1 MILLION IN TRADE VALUE, THE COMPANY WOULD PROBABLY BE ONLY WILLING TO COVER UP TO HALF OF THAT VALUE NOW. AND IF FINANCIALS FROM THE CLIENT ARE NOT UP TO DATE, THEY WOULD PROBABLY SAY 'NO'. EVERYBODY IS TAKING A MORE CONSERVATIVE APPROACH IN THE UNDERWRITING OF THE CREDIT RISKS."

MIKE KAYES / TRADE CREDIT MANAGER, QBE INSURANCE

Atradius New Zealand's country manager Kevin Harris.

Neil Bhikharidas from Aon Trade Credit, a trade credit insurance broker, says increasingly businesses seeking cover would have to be very up-to-date with their financial information on debtors. "What we are seeing is that for clients with trade credit programmes, insurers are standing by them. For these clients, to maintain their exposures, they need to have updated financial information on their debtors – where financial information is not provided, there have been issues for renewing these policies."

He adds: "What is critical for exporters to do is to continue to manage their risks. They need to be more wary about whom they are trading with, and be prudent about collection and not stray on accounts that are overdue."

New Zealand Council of Wool Exporters executive officer Nick Nicholson says it is not surprising the trade credit insurers are toughening up as "they have taken some large hits in the last six months". The wool industry has been experiencing problems in the reduction of individual trade credit insurance limits and some banks have toughened conditions on forward sales making it hard for the wool industry which typically has forward deliveries.

Nicholson is however heartened by the fact that the Export Credit Office (ECO) is stepping in to meet the demand for trade credit insurance cover for the wool industry where private insurers and banks have not been able to.

Carmen Moana, senior underwriter at the ECO, says her organisation is exploring the concept of co-insurance between the ECO and the private sector, where the ECO will help provide part cover in deals where private sector firms are unable to fully take on full cover due to their risk limits.

In February, the ECO revamped its product and processes to make them more market friendly. The government gave exporters a shot in the arm by providing $50 million to ease trade credit cover for exporters.

"We see a role for the ECO, in helping to meet the private sector's inability to cover the wool sector, for instance. But the transaction still has to meet our criteria. We are in discussion with the wool sector on

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CARMEN MOANA / SENIOR UNDERWRITER, EXPORT CREDIT OFFICE

Risks rising

- Nearly 82,000 Kiwi companies have had their risk or payment profile downgraded since January 2008. This is the largest number of downgrades ever in a 15-month period, according to Dun & Bradstreet.
- Close to 38,000 firms are now rated a higher risk of financial distress in the coming 12 months and a further 44,000 are more likely to pay their trade accounts in a severely delinquent manner.
  – Dun & Bradstreet

Managing your trade credit insurers

KEVIN HARRIS, COUNTRY MANAGER FOR ATRADIUS NEW ZEALAND, PROVIDES SOME TIPS FOR EXPORTERS WHO ARE SEEKING TRADE CREDIT COVER.

1. **Establish a clear credit policy.** This provides a consistent guideline for how your company will manage its receivables.
2. **Make sure the customer understands your business terms.** A clear contract that outlines payment periods and terms and conditions, will help resolve potential legal problems.
3. **Know your customer.** It is essential to capture and maintain accurate customer data so you know who to chase for late payments.
4. **Check creditworthiness.** Offering credit terms without adequate or up-to-date creditworthiness is like playing Russian roulette. Depending on the business volume and risk assessment, regularly check your customers' credit rating.
5. **Measure key indicators.** Monitoring key figures such as 'average days of sales outstanding' and 'debtors' financing costs' will identify cash flow trends. Look out for customers who consistently exceed their payment terms.
6. **Set credit limits.** Allocate the maximum line of credit you're willing to offer to individual customers based on their creditworthiness rating. Overshooting a credit ceiling should trigger appropriate reactions.
7. **Payment on your terms.** Having access to a variety of payment terms will enable you to set your exposure for each customer individually depending on their risk profile – for example, prepayment, down payment, discounts and due dates.

how to fill the gap left by the private sector (insurers)," Moana says. She adds that the exporters still have to meet the ECO's underwriting standards and make sound commercial sense. In all cases, exporters have to explain why they can't get private sector insurance cover.

Exporters will be notified how long it will take the ECO to approve an application and "we may take longer" due to the information needed. She adds however that the ECO aims to get a deal approved within 10 days.

The ECO is also in discussions with three trade credit insurers – QBE, Atradius and Euler Hermes – on plans to roll out a co-insurance programme to meet the demand by exporters. **[END]**

Note: Just before this magazine went to print (on June 24th), the government announced an extension of $100 million in short-term trade credit insurance guarantee for exporters.

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