

Credit Risk

Knowing me, knowing you*
What suppliers and buyers need to know about measuring risk and managing credit insurers

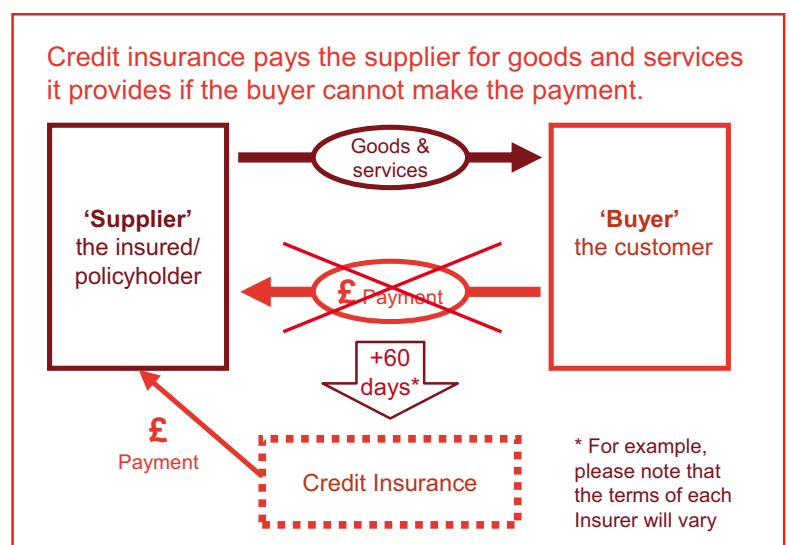
Credit insurance, a topic that was barely mentioned a year ago, now finds itself in the spotlight as one of the most talked about issues for businesses.

Credit insurance is unlike other forms of insurance; the levels of cover can be cut and withdrawn at very short notice. The impact on buyers and suppliers alike can be devastating; it can adversely affect supply chain and cash flow, and the withdrawal of credit insurance for suppliers can also attract extra and unwelcome attention from stakeholders into the finances of the buyer.

On the face of it, the Government's proposed scheme (announced in the Chancellor's 2009 Budget) to 'top-up' credit insurance for those who have had cover reduced is a welcome lifeline. However, limitations have been expressed; companies will only be eligible if their cover was reduced after 1 April 2009, and even then, they will only be able to purchase six months' 'top-up' insurance. The ability to 'top-up' has always been available commercially, albeit at a higher premium level.

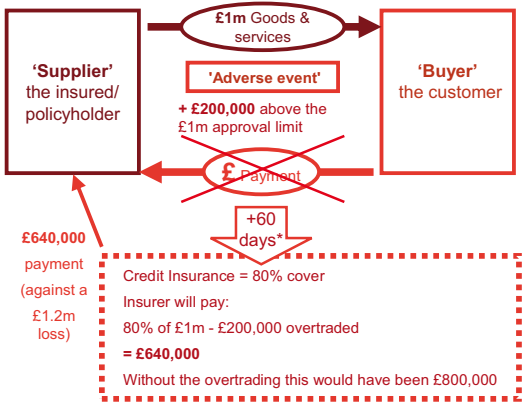
The reality for many companies is that credit insurers are an increasingly powerful financial stakeholder. If you are a buyer, do you know how many of your suppliers rely on credit insurance?

If so, what is the level of cover and which insurer is the policy with? In this context, whether you are a buyer or a supplier or both, what key areas should you consider to mitigate your risk?



Example of a basic credit insurance model

If you are a supplier:

Potential issue	Are you at risk?	How we can help you
<p>My credit insurer has requested more information about my buyers. I think my cover may be reduced or withdrawn altogether.</p>	<ul style="list-style-type: none"> • How regularly do you communicate with your buyer? • What financial information on the buyer do you have to give insurers? • What are the terms of your policy? Have you reported any payment anomalies or other material information on the buyer to the insurer? • The onus is on the supplier to keep the insurer informed at all times; are you sure you are fulfilling all your obligations? • Have you considered the impact of sudden changes to credit and supply terms? 	<p>Credit insurers will request timely financial information if they feel there are risk issues that need satisfying for credit approval levels to be retained. Our experience dealing with credit insurers has shown that how you present to and engage with insurers makes a huge difference to the outcome.</p> <p>We can facilitate dialogue with your credit insurers, as well as key customers, to drive robust financial information and assist in the preparation and presentation of that material. Our goal would be to help you maintain cover, maximise approval limits and achieve value for money.</p>
<p>My approval limit with a key buyer has been reduced. What can I do to maintain trading at current levels?</p>	<ul style="list-style-type: none"> • What are the terms of your credit insurance policy? • How restrictive are the terms? • Are you considering or are you currently supplying goods on a pro-forma basis? • What credit terms do you have with the buyer? • How have these changed in the light of changes to your approval limits? • Have you considered and compared different credit insurance terms? • What actions are required to bring buyer payments to terms, so as to enhance your ability to renegotiate premiums and coverage? 	<p>Knowing the terms of trade is fundamental – each insurer has its own agreement/policy. For instance, some insurers have a ‘salvage waiver’ clause in their policy, which means that if an ‘adverse event’ occurs, such as irregular payments, you may need to agree in advance any trading over the approval limit. Failure to do so may have implications, including reducing the insurer’s liability and therefore your potential payout from the insurer. For instance, the following scenario would result in a shortfall of £160,000 paid to the supplier.</p>  <p>Potential loss increases because of trading over the approval limit without disclosure or agreement upfront with the insurer.</p>
<p>How do I know if one of my buyers is a ‘high risk’ to credit insurers?</p> <p>I am concerned I might have to stop supplying key customers if my credit insurer reduces or withdraws cover.</p>	<p>Has your buyer:</p> <ul style="list-style-type: none"> • Consistently paid invoices late? • Filed accounts late? • Had worse than expected results? • Breached banking covenants? • Been subject to adverse publicity regarding its funding requirements? <ul style="list-style-type: none"> • How frequently do you have active dialogue with your buyers? • Have you engaged with your buyers to pre-empt potential risk and the knock-on impact to your insurance coverage? • How have you measured the skill set of your credit teams, and their ability to manage risk, should cover be revoked? • Do you want to move away from credit insurance altogether? If so, what are the alternatives? • What proportion of your income derives from vulnerable businesses/industry sectors where cover is being withdrawn? 	<p>It is important to understand the risk profile of your customer base and take steps to mitigate trading risk accordingly. We can help identify and deal with early indications of buyer risk.</p> <p>We can compose a risk profile of your buyers, and look at your cash flow exposure in the event of different scenarios of buyer combinations failing – measuring risk in this way may reduce premiums or allow you to consider whether there is a need for credit insurance in the first place.</p> <p>We can also compare different policies/terms and stress-test them to measure sudden changes to credit and supply terms and know how that might affect you.</p>

If you are a buyer:

Potential issue	Are you at risk?	How we can help you
There appears to be some adverse publicity around my business, making suppliers fearful of trading with us, and putting customers off buying from us.	<ul style="list-style-type: none"> Have you had negative publicity in the press, or rumours circulating in the public domain, over the health of your business / finances? Have your other financial stakeholders been in touch to review the business? What information have they asked for? 	<p>We have a strong track record of managing stakeholder relationships and significant expertise in crisis situations where there are financial, resource and time constraints. In the short term, we stabilise the financial position of the business and obtain both management and stakeholder buy-in, including credit insurers and strategic suppliers. In the longer term, our role is to rebuild confidence and relationships whilst helping management regain control, keeping all parties informed every step of the way.</p>
A credit insurer has requested a site visit/ meeting with us. What does this mean?	<ul style="list-style-type: none"> How quickly have you responded to any request from credit insurers? What timely financial information such as management accounts, do you have readily available? Have you drawn up a confidentiality agreement with the insurer? How will you present and engage with the insurer? Who on your management team will be in the meeting? 	<p>Credit insurers will request timely financial information if they feel there are risk issues that need satisfying for credit approval levels to be retained. Our experience dealing with credit insurers has shown that how you present to and engage with insurers makes a huge difference to the outcome. We can facilitate and assist in engagement with the insurer and help you to prepare, draft and present robust information to them to address their concerns.</p> <p>Our goal would be to support you in maintaining cover and maximising approval limits for your strategic suppliers. Failure to respond to credit insurers is likely to be viewed negatively and may result in immediate withdrawal of cover.</p>
I am worried that I might lose strategic suppliers if the credit insurers reduce or withdraw cover.	<ul style="list-style-type: none"> How frequently are you in active communication with suppliers? Are you paying your suppliers within terms? What is the likelihood of you filing your accounts late? Are your results expected to be better or worse than peers in your sector? Have your suppliers indicated that they are at threat of having credit insurance withdrawn? What other risk have you identified within your supply chain? 	<p>Contingency planning can prevent problems in the supply chain from developing by identifying and managing risk in the supply chain.</p> <p>We can look at your suppliers and conduct strategic market analysis to identify alternatives to both suppliers and the specification of goods purchased. In addition, we can help to improve the business performance of existing suppliers or renegotiate trading terms to reduce risk.</p>
Our liquidity is being squeezed as suppliers tighten credit terms or demand payment up front. We are in danger of breaching our banking covenants.	<ul style="list-style-type: none"> What is your short term cash flow situation? Are you able to satisfy more restrictive credit terms. If so, how much headroom do you have? Have you undertaken scenario planning to fully understand any impact on working capital. What was the outcome? What facilities do you have to fund increased working capital. How much headroom do you have? 	<p>We can optimise cash and working capital to respond to short-term liquidity issues, whilst balancing any potential knock-on impact that might have with credit insurers. We can work alongside you to understand your cash concerns and explore the cash levers across the entire P&L and balance sheet, both in the short term and on a sustainable basis.</p> <p>We can support you in developing scenarios to assess the impact of reduced / withdrawn credit terms and other options such as measuring the flexibility of your business to more restrictive payment terms.</p>
I don't want my suppliers to have any credit insurance. Is this realistic? What are my options?	<ul style="list-style-type: none"> How strong are your relationships with strategic suppliers? Do you have a good history of paying suppliers on time and within terms? To what extent have you considered the cost-benefit analysis of having, or not having, credit insurance? How would your suppliers react if you took the stance of not accepting to be bound by credit insurance? 	<p>There are some options that may be available if you want to move to a 'no insurance' model. Working with your strategic suppliers, we can help to manage a reduction in the levels of credit insurance cover.</p> <p>Self insurance through captive insurance arrangements is becoming an increasingly important consideration. Captive insurance is effectively an 'in-house' insurance company to insure collective risk across the organisation. It allows companies to protect themselves financially and have more control over how they are insured. We can review your risk management strategy and advise on whether a captive would be the best option for managing risk.</p>

How can we help?

Knowing me, knowing you – how we can help you measure your risk and manage credit insurers

Stakeholder management: engaging and negotiating with credit insurers and key trading partners.

For both suppliers and buyers, it is essential to have active dialogue with credit insurers and key trading partners. We can facilitate engagement with credit insurers themselves and assist in negotiations to reinstate or maintain cover.

Alternatives to credit insurance.

We can help to manage a reduction in your insurance cover, and explore what other options may be available as an alternative to credit insurance.

Cash is king: addressing liquidity and working capital concerns.

We work alongside you to understand your cash concerns and explore the cash levers across the entire P&L and balance sheet, whilst balancing any potential knock-on impact that might have with credit insurers.

Contingency planning: measuring risk exposure and optimising supply chain.

By reviewing your exposure to key trading partners, along with an objective review of your business, we can help you better understand your risk.

Measuring and knowing your risk may reduce premiums or allow you to consider whether there is a need for credit insurance in the first place.

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Further reading:

pwc.co.uk

Supplier Risk:
pwc.co.uk/supplierisk

CFO Survival Guide:
pwc.co.uk/survivalguide

Managing in a downturn:
managinginadownturn.com

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