



Credit Risk

Crisis on the Credit Insurance Market “Recipes” for effective risk management



Crisis on the insurance market

All operators (Brokers, Insurers and Credit Managers) agree that they have never seen such turmoil on the credit insurance market. The serious economic and financial situation that our country is going through is giving rise to a total and urgent transformation of the credit insurance market.

Until now, price fixing was through the free play of supply and demand which, in an extended period of good economic performance, had in fact turned credit insurance into a “commodity”.

In a business closely linked to economic cycles, it was foreseeable that a sudden radical change in the economic situation would automatically require a major transformation of market prices policy. Taking into account the fact that achieving such a transformation requires a period of adaptation, in a scenario of runaway claims ratios the sudden imbalance between the premiums received and the claims ratio borne by companies was inevitable.

The latest figures published demonstrated that the claims are increasing and loss ratio are now exceeding the 100% in most of the European countries.

In addition, faced with this growing claims ratio, reinsurance contracts have been renewed in conditions demanding greater rigour and control over risks, such as strong increases in reinsurance premiums.

In short, the insurance market seems prepared to modify the bases for price-fixing, using as the central core the formula of “pricing per risk” and leaving aside criteria with less technical risk. “This is the way”, say the insurance companies, “which will guarantee the sector’s future”.

Summary

- Crisis on the Credit Insurance Market
- Difficulties faced by the insured
- “Recipes” to confront the crisis



Difficulties faced by the insured

Our clients and in general all insured persons with policies taken out in most of the European countries are faced to a greater or lesser degree with substantial changes and different measures adopted by credit insurance companies trying to contain their growing claims ratios.

In this respect we noted following measures:

1. Changes in the criteria for underwriting risks: as they become harsher, risk limits are being reduced and cancelled, with a greater incidence in particularly dangerous sectors.
2. Technical modifications to contracts: introduction of first loss clauses, extension of compensation payment periods to 12

months, reduction in percentage cover, elimination of allowances for study costs or low claims ratio, incorporation of penalties for high claims ratios, etc.

3. Stricter approach to the acceptance of claims: we can see a harder attitude and greater controls on the part of companies in accepting claims, for which reason it is essential for exhaustive fulfilment by the insured of their obligations in terms of time limits, documents, etc.
4. Exponential increase in prices: the increases in rates vary, according to the company, from fixed minimums of between 20% and 35% to increases of over 100% in the most dramatic cases of high claims ratios.
5. Aggravated risks: exceptionally, in particularly serious cases of high claims ratios, some companies are cancelling contracts whilst they are still in effect, benefiting from the various Insurance Contract Law which refers to the concept of "aggravated risks".
6. Changes in companies' decision-making structures: the technical departments for Claims, Risks and Products (which fix prices and conditions within companies) have been given a more proactive role to the detriment of commercial offices, which have now seen their technical functions limited.
7. Refusal of new business underwriting: new contracts linked to the sectors most affected by bad debts, such as the building industry and auxiliary industries, the chemical and automotive industries, etc., are systematically rejected.

8. Preventive cancellation of 100% of expiring contracts: in accordance with the notification period letters are being sent out to most of the insureds reserving the right to modify the conditions for the next annual payment or simply cancelling contracts.

"Recipes" to confront the crisis

As a result, it is quite clear that the days when it was possible to obtain cover for practically all credit sales operations have come to an end. Insurance has ceased to be a single and 100% effective solution for all problems arising from bad debts. In these new times, perhaps not for ever but certainly for many years to come, credit insurance is turning into a vital and extremely important tool for the effective management of credit risk, but one which must be supplemented by other products and procedures.

In this respect, Marsh recommends that more than ever risk control policies be intensified at both internal level (credit management) and external level, i.e. in relation to the optimisation of credit cover programmes.

Other measures to strengthen credit management are:

- Involving and raising the awareness of commercial teams in the management of credit risk.
- Developing additional internal controls for the purpose of continuously monitoring and assessing the risks in course.

- Seeking out additional guarantees for the insurance policy where necessary.
- Shortening payment terms as far as possible.
- Setting up risk committees in companies.
- Strengthening the client administration teams, especially in times of crisis.

Some suggestions for effective insurance management are:

- Constant daily monitoring of the trend in limits allowed by insurers.
- Absolute rigour in the fulfilment of obligations by the insured in their policies, such as:
 - Time limits for submission of claims and notifications of non-payment.
 - Sales statements.
 - Payment of premiums.
 - Non-aggravation of risks.
 - Communication of extension periods.
 - Having all the original substantiating documentation in the event of a claim.
- Periodic meetings with the risk analysts of the insurer. In spite of the fact that their accessibility is very limited at present, thanks to proper coordination with Marsh our clients are able to maintain useful working meetings with the analysts of the different companies.
- On technical subjects, due to the avalanche of incidents the branches of companies currently have difficulties in solving cer-

tain problems, which is why it is important for you at the same time, through Marsh, to turn to those who really will be able to influence decision-making.

- It is essential to be proactive and creative in designing new forms of insurance based on structured and combined products such as Excess Loss, Top Clients with or without first loss, Single Risks and Top-Up covers.

Finally, there are specific cases in which despite the above-mentioned measures it will not be possible to attain minimally acceptable levels of cover, be it due to high risk concentrations or the fact of being in business sectors most affected by bad debts. In these cases, Marsh can help companies to move towards risk management models oriented to credit management (internal measures), supplemented by XL type or catastrophe credit insurance which guarantees at least the removal of uncertainty and the impact of major claims which can compromise the survival of the company.

Faced with an uncertain economic future, in which credit insurance and other complementary products are going to play a fundamental role in preserving your company's profit and loss account, Marsh can help you to obtain all the protection that the national and international markets can offer you. The new era of credit risk management demands a new vision of risk management in which the capacity for innovation will make all the difference, the same capacity for finding innovative solutions which has made us leaders for more than 130 years.

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