# Trade Credit Insurance

## Lessons learned from the global COVID-19 pandemic

CHUBB®

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# Political Risk & Credit Claims

## COVID-19 : Impact on Claims

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# Overview

- Themes and Trends

- Case studies
    - Trade Credit Singapore oil sector
    - Trade Credit US retail
    - Trade Credit Chinese textile manufacturing
    - Political Risks Asia Pacific Satellite programme

## Themes and trends

- Globally, governments are offering financial incentives to prop up economies
- Once government support reduces, more insolvency/defaults anticipated
- European and UK governments offering government backed scheme for trade credit insurers (Chubb not participating)
- UK Government rushed through a new law to encourage business rescue and make it more difficult to put businesses into liquidation
- Less liquidity and more onerous due diligence for borrowers
- Weaker businesses face increased pressures

## Themes and trends

- Likely that there will be greater political and civil unrest
- Anticipate claims impact of COVID will continue for next 1-2 years
- We expect to see greater scrutiny of lending practices and supply chain finance structures
- Certain insurers pulling out of market due to high value claims
- Certain lenders closing trade commodity/supply finance units

## Case Study 1 – Trade Credit Singapore oil sector

- In April 2020, a Singapore Oil Trader collapsed after its founder admitted to investor banks to having concealed $800 million of losses
- 23 bank lenders are understood to have exposures of $4.4 billion
- The market's exposure to claims exceeds $100m
- The fraudulent conduct had been ongoing for some time and included:
  - Allocation of funds received from one customer to another customer's account to inflate receivables balances and cover up losses (known as teeming and lading)
  - Selling cargo and then buying it back immediately at a lower price whilst overstating inventory balances to obtain financing
  - Forging sales invoices to secure factoring facilities from banks

## Case Study 1 – COVID impact

- Fraud was perpetuated prior to the COVID pandemic
- However, the COVID pandemic acted as a trigger resulting in:
  - Global crash in oil prices
  - Greater scrutiny by banks of loans/credit facilities
  - Less availability of credit
  - Businesses with weak or heavily indebted balance sheets being unable to borrow
  - Long-standing fraud becoming harder to hide

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## Case Study 2 – Trade Credit US retail

- Chubb provides multi-buyer credit insurance to a US Insured
- The Insured provides credit to a large number of US retail outlets via a financing mechanism known as factoring
- Since May 2020, four retailers have filed for protection from creditors under Chapter 11 bankruptcy proceedings
- Indebtedness exceeds $6.5m
- At least four more are reporting severe financial distress which may result in additional losses of $14m
- We anticipate that number will grow

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## Case Study 2 – COVID impact

- The US retail sector was struggling prior to COVID pandemic
- Retailers with more high street outlets and poor online sales/presence have suffered most
- Lockdown and post-lockdown restrictions have led to less footfall/in store purchases
- Inability to pay rent for stores that are not generating income
- Inability to secure additional lines of credit
- Warehouses with stock that cannot be sold

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## Case Study 3 – Trade Credit Chinese Textiles

- Potential claim under a policy that covers the Insured for financial obligations of a buyer which is a large Chinese textile manufacturer
- The buyer experienced financial difficulties in managing its debt in 2019
- The debt currently exceeds $5.5bn

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## Case Study 3 – COVID impact

- Insured's financial difficulties have been exacerbated by the COVID pandemic
- Ratings agencies have downgraded the company's rating multiple times in the last 12 months.
- A planned capital injection to help with the debt load has been cancelled.
- The future of the company appears to turn on the willingness local government which has quasi-ownership of the group to financially intervene

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# Case Study 4 – Asia Pacific satellite programme

- Potential Claim arising from investor pulling out of a programme to build and launch a satellite in Asia Pacific
- A notification has been made by the Insured which is pursing negotiations with the Ministry of Defence
- Depending on outcome of discussions, the contract to build the satellite may be cancelled in which case the Insured will likely make a claim
- The Insured’s loss of contract value stands at over $28m

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## Case Study 4 – COVID impact

- COVID has led to increased investor caution
- Governments globally are having to shore up economies
- Funds for long term projects being diverted
- In emerging economies this has been more acute

# Political Risk & Credit

## COVID-19: Impact on Supply Chains

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# Overview

- General supply chains
- IT & consumer electronics supply chains
- Industrial supply chains
- Commodity trade finance
- Other supply chains
- Lessons learned

# Supply Chains: General trends

- Covid-19 has accelerated a trend away from “ultra-thin” supply chains that materially reduce costs, but are very sensitive to open borders and uninterrupted trade flows, towards increased resilience:
    - Near-shoring and re-shoring
    - Multi-source supply chains (i.e. “China +1/+2”)
    - Reducing unique inputs & increase inventories
    - Improving risk management procedures
- Governments will help firms re-shore manufacturing centres, particularly for sensitive sectors such as electronics components and pharmaceuticals, which are overly reliant on China
- This will be credit-positive for firms as it strengthens their supplies and reduces business risk – but it will also raise costs
- Pandemic also exposed many fraud cases and there is more to come…

# Supply Chains: General trends (cont.)

- Covid-19's impact on supply chains vastly differs for each sector

## Higher Impact

- High trade intensity
- Relying on a few exporters
- High labour intensity
- Multi-tiered supply chains
- Electronics, telecoms, apparel, industrials

## Lower Impact

- Low trade intensity
- Lower trade intensity
- Storable goods
- Critical sectors
- Food & beverage, fabricated metals, medical devices

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## IT & consumer electronics supply chains

- Initially, computer and electronic components faced the biggest risk of global supply-chain disruptions stemming from the pandemic
- These supply chains tend to be among the thinnest as they source hardware and intermediaries from the East to sell to the West with less need for storage networks
- IT supply chains are not as much impacted by Covid-19 as by the US-China tech war, which is leading to a “decoupling” of the two hemispheres: but this is not easily done (see next slide)
- There will be increasing government support to build chip manufacturers at home (re-shoring) or in “trusted countries” (near-shoring)
- The trend towards strengthening supply chains will be particularly challenging for IT firms whose business model relies on “just-in-time” deliveries and few storage facilities (Dell)

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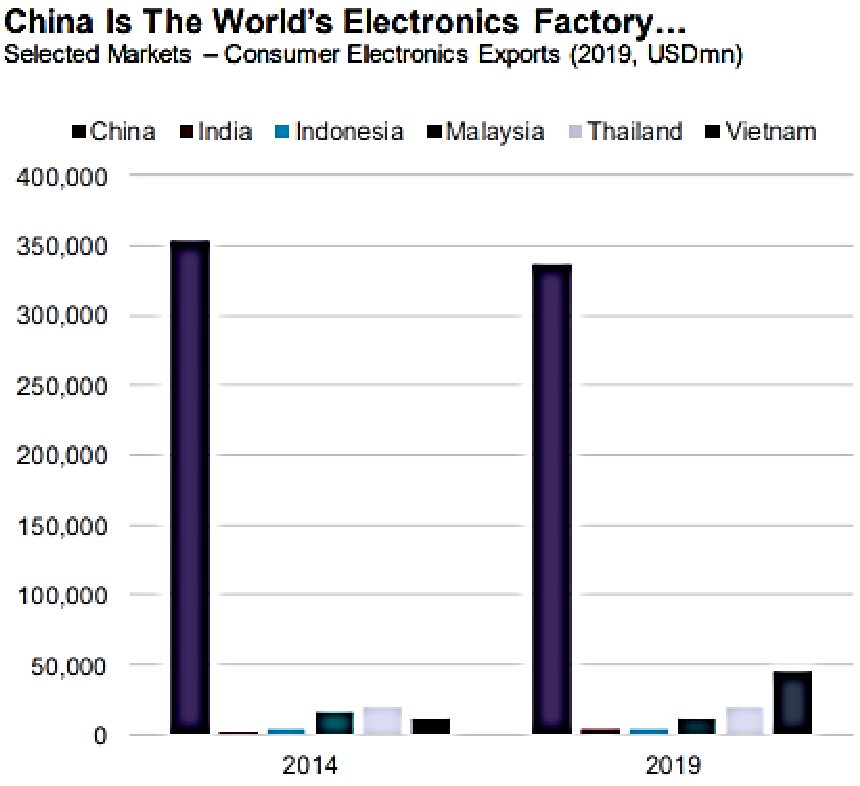
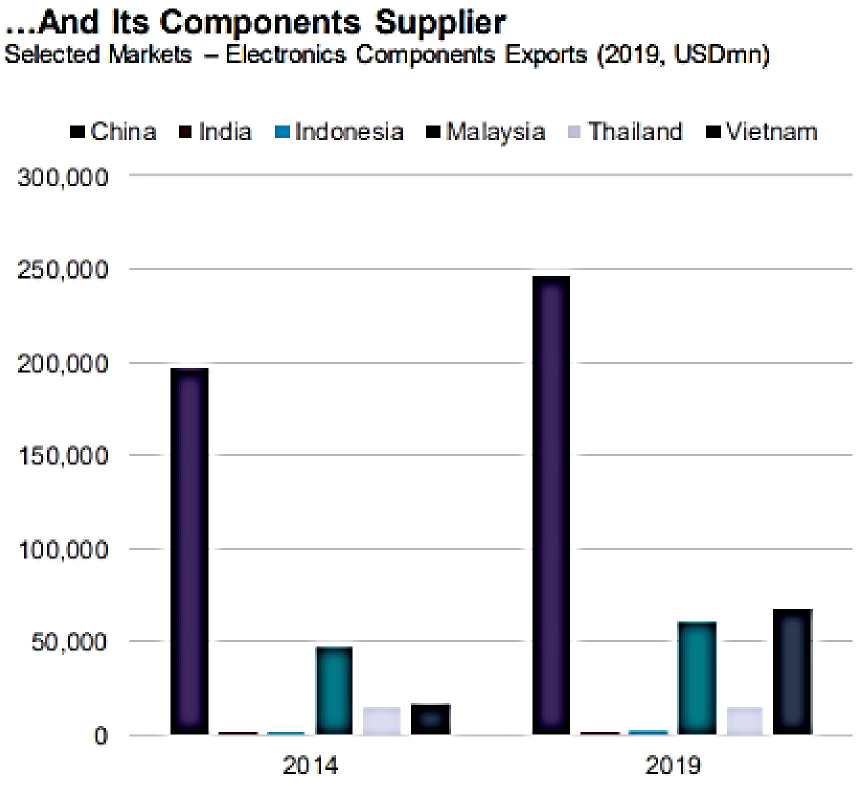
# IT & consumer electronics supply chains (cont.)

## Electronics: China Still The Key Player In Any China + 1 Strategy




Source: Trademap, Fitch Solutions

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# Industrial supply chains

- Industrial supply chains are among the most complex, often relying on a cascade of suppliers, conventionally categorised as T1 and T2:
  - T1 suppliers are mainly OEM that supply the end-firm, such as plane makers (Rolls Royce) or car manufacturers (Goodyear)
  - T2 suppliers supply T1 suppliers
- Covid-19 restrictions severely disrupted that cascade, with health-based lockdowns having a material impact on their European and American clients (Examples: Volvo, GM, Dell)
- Pharmaceutical supply chains are more diversified, given the critical need to have a robust supply of API (active pharmaceutical ingredients)
  - If necessary, large pharma firms can produce key API in-house
  - But this would raise prices, creating political pressures (USA)

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# Commodity trade finance

- Low trade volumes and high costs at ports due to loading restrictions resulted in collapsing revenues
- This resulted in loan losses to banks as traders’ sales revenue didn’t cover trade finance obligations (designed to be self-liquidating)
- Lower trade volumes and collapsing oil prices revealed substantial fraud (especially in Singapore: Hin Leong, Hontop etc.)
    - Trading losses had been covered up
    - Secured inventory had been over-pledged
- Many banks ended or reduced commodity trade finance operations in Singapore (ABN Amro, SocGen, BNPP)
- This will substantially reduce overall lending capacity in the market and might push “good” traders into bankruptcy
- But Covid-19 seems to have accelerated a trend rather than create one

# Other supply chains

- Protein production supply chains were severely impacted by Covid-19 restrictions due to social distancing measures, factory shutdowns (Tönnies), and employee absenteeism despite government orders
- Vulnerability in food supply chains is pushing countries towards increased self-sufficiency and expanding cold storage capacity
- Covid-19-related measures materially reduced the capacity of major ports to process shipping cargo:
  - This had a big impact on companies that relied on intermediary products: Samsung flew critical parts in (“size matters”)
  - Similar impact on energy (crude, coal) and commodities which can “go off” (esp. LNG)
  - But the worst impact was on perishable agri-goods
- Building product supply chains tend to be low risk as inputs are simple

# Lessons learned

## Credit analysis focus on resilience

- “Cash is King”: Liquidity is the most important factor in a crisis
- Working capital management and access to credit is critical
- Cost analysis: the lower fixed costs, the lower the vulnerability
- In a crisis, a company may only be as strong as its supplier network

## Size matters

- Larger firms can access alternative sources for critical inputs (in-house API production, flying in products)
- They have also better access to finance
- Can use part of that finance to keep their suppliers afloat (Boeing)

## KYC & DD very critical

- Pandemic unveiled a lot of fraud (NMC, Wirecard, Hinleong)
- Risk management procedures at obligors important (booking centres)
- Typical for end of a cycle: Corporate governance is paramount
- Insureds’ relationship with the obligor is very important

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If you have any further questions, please contact:
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