What does the future hold?

Insurance has become a hot topic with big premium rises in many areas. Ian Box reports on what's happening in credit insurance and what future trends might be.

THERE HAS BEEN A LOT of publicity surrounding the rise in insurance costs over the past year or two, particularly with regard to Professional Indemnity and Public Liability covers. Whilst domestic covers have been reasonably stable in pricing, commercial insurances for property have also risen dramatically.

The Last Two Years

The credit insurance industry has always delivered a commercially reliable and stable pricing structure and has not been prone to wild fluctuations. Of course, when insurers are experiencing a rise in claims associated with economic recession, premium rates increase, but typically no more than 10 to 20 percent from one year to the next.

During the past decade premium rates have drifted downwards as a general trend due to increasing competition, but over the past two years, following the large number of claims experienced in 2001, all credit insurance premiums have experienced some reasonable rise and should now stabilise.

Unfortunately, the underwriting marketplace has narrowed again. Notably we have seen FAI and HIH removed from the market and CGU deciding to discontinue its credit insurance activities with its run-off portfolio being acquired by QBE. QBE, along with Dexta (Coface), AIG and Gerling/EXGO are the only Australian insurers of domestic credit risk. An underwriting agency in New Zealand fronted by Lumley NZ also offers cover in New Zealand and for related Australian businesses.

Credit insurance claim numbers have fallen steadily over the past two years. This is supported by the workload being carried by Australia's insolvency professionals who, some may be surprised to know, are complaining about a lack of new jobs.

The Australian economy has, of course, performed exceptionally well compared to other western economies. We have had a sustained period of low interest rates that seems likely to continue, the housing sector has been kept buoyant by the Federal Government's grant schemes, there has been little industrial strife and wage increase pushes, while at the same time, inflation has been kept low and there has been a well-publicised home property boom.

Correspondingly, of course, there has also been a well publicised rise in personal debt levels and any future upward movement in interest rates and/or the prospect of deflation could prove to be extremely volatile.

The Next Two Years

Trends worldwide reflect an increasing use of domestic and export trade credit insurance. The relatively mature marketplaces in Europe, and also Australia, will continue to experience growth. For some time there has been an expectation of this product emerging in the Asian marketplace, but at this stage it is unlikely to accelerate quickly outside of Singapore, Hong Kong and perhaps Japan until such time as there is an improvement in insolvency law and available credit assessment information.

One of the most significant international emerging marketplaces is the US, where surprisingly credit insurance is a product that has only started to be more widely used in the past 10 years and still only has a small premium income.

Businesses in the US have embraced the concept of factoring and other forms of non-recourse financing, which are accepted practices. The failure of Worldcom, Enron and K-Mart US have caused significant losses in both the credit insurance and surety marketplace, which may slow the growth of the product in terms of interest shown by new insurers looking at the US. Unfortunately, surety and credit insurance are viewed together by the re-insurance market-

place when measuring underwriting performance.

The capital required by the rating agencies to support re-insurance of surety and credit insurance is generally 70 percent of each premium dollar written, compared with a requirement of only generally 25 percent for every dollar written for property covers. A credit insurance product is therefore capital thirsty and this has caused a review by re-insurers of their willingness to commit support to treaty and stop-loss re-insurance programs for credit insurers internationally. A number of re-insurers who have historically supported credit insurance have withdrawn from the marketplace and there is pressure on pricing from those who are still willing to support the primary insurers.

Those primary insurers that are strong users of re-insurance protection may be forced to increase premium rates into the future due to these commercial pressures.

Generally speaking, there is little expectation of new credit insurance underwriters coming into the marketplace, which will ultimately be dominated by the specialist insurers and there are a number of these who are mono-line companies operating on a broad international scale. In the next 12 months we expect more interest in Australia and New Zealand from some of the European credit insurers and further scope in the marketplace following the privatisation of EFIC.

It is our expectation that we should see a reasonably stable economy subject to the prospect of interest rate rises that may occur in the next two years. That might see a rise in insolvency numbers and claim ratios for insurers, but at present claim ratios are satisfactory and adequate to sustain stable pricing.

Key Benefits of Credit Insurance Protection

The ability for business to preserve profit.

Protection of liquidity and cashflow with the proceeds of a credit insurance claim injecting funds back into the business.

Confidence to expand sales knowing that exposures are underwritten and reliable credit limits are set.

Credit management information is strengthened with third party limit decisions and independent financial appraisal.

Additional security is available to support lenders and shareholders.

Why take out Credit Insurance?

The answer is that the risk of a bad debt does not need to be an accepted risk of doing business.

Bad debt reserves that are generally carried on balance sheets do not address the issue of lost cash flow and only subsidise the impact on profitability in an artificial manner. The pure financial equation of paying an insurance premium in return for an underwriter carrying a company's future bad debt losses is a relatively simple concept.

It is our experience still that many businesses are largely unaware of the ability to insure against this risk. The

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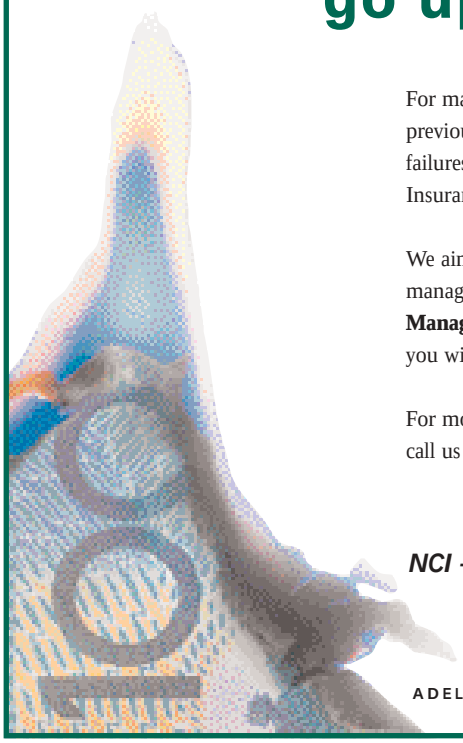

For many companies today, business has never been more volatile. Companies that were previously considered "blue chip" have been among the most spectacular business failures. It follows therefore that the need for professional Credit Management and Insurance Protection has never been greater.

We aim to partner our clients with innovative solutions in trade credit information, risk management and insurance protection. With **NCI's Credit Insurance** and **Credit Risk Management**, you will not only protect your business against the cost of Bad Debt, but you will also increase your cash flow through advanced credit management procedures.

For more information on how **NCI** can assist you make the most of your profits, please call us on **1300 654 500**.

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NCI Credit Insurance

NCI Credit Risk Management

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future promotion of credit insurance rests largely on the marketing activities of the specialist brokers. The European experience indicates that increasing market awareness is generated by lending institutions which promote cover, particularly where a client has a heavy reliance on cash flow and debtors as an asset. NCI has a number of strategic alliances that have been developed with lenders who are showing an increased awareness of the product and its benefits from a marketing and risk control perspective.

Whilst some of the largest users of credit insurance are medium to large corporations that buy their cover not only for cash flow benefits but for risk management controls, there is a need to increase the availability of a product for smaller businesses.

It is our expectation that we could shortly have a total credit solution product available for smaller businesses, ie those with turnovers below $2 million per annum, and this should be available in the marketplace within the next three months. This will be a simple to purchase and cost effective cover that will deliver risk management advice, underwriting of the major debtors and collection support as a total solution for smaller businesses who could not normally afford credit management expertise or have all of those resources available to help protect their future position and support growth.

Future Management of the Credit Risk

Even the most rigorous credit management cannot prevent occasional bad debts.

With the prospect of a tightening insurance marketplace, more than ever an emphasis on risk management control in credit is vital.

Whilst NCI was initially established 18 years ago as a specialist insurance broker, we realise that our business is actually about protecting the profitability of our clients. Credit insurance is still the ultimate safeguard against bad debts but better business practices in trade credit management also help to improve profitability on a day-to-day basis. Over the years we have developed a complete range of trade credit services intended to provide a holistic approach to support each clients' future management of such an important asset.

Apart from credit insurance, there are a range of risk management services available from the simple provision of information prepared on an up-to-date and fresh basis through to independent credit limit analysis, debtor monitoring and pro-active risk mitigation advice. Specialist services in the area of collection support and recruitment and personnel are also available, providing a broad range of credit related services but all interactively supporting the protection of each clients' profitability.

The future management of credit will, in our view, become more reliant on active management in all areas of a business once the sale has been made. There is an increasing pressure on margins and efficiencies in business and the future of an active credit team will have less and less to do with the traditional functionality of an in-house credit department. ■

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