TRANSCRIPT: Tradecast - Growing uncertainty in Trade Credit Insurance: what does this mean for the industry? Part 2

Featuring

Gary Lowe, global head of the Global Credit Insurance Group, Standard Chartered
Jérôme Pezé, CEO, Tinubu
Janusz Władyczak, CEO, KUKE (the Polish ECA)
Richard Wulff, executive director, ICISA

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Deepesh Patel

I guess let's go into a bit of a macroeconomic overview, and especially given your such critical position as CEO of the Polish ECA. Janusz, can you give a short overview of how the economic landscape has fared and also changed since the pandemic, and how the fallout's also been compounded by the current political risks that we're seeing?

Janusz Władyczak

Sure, Deepesh. I think what we are currently observing, is obviously... As I mentioned before, we have a couple of issues going on, which means that from the macroeconomic perspective we had a nice v-shape bouncing after COVID so everyone was pretty excited that finally we are speeding up and, let's say, trying obviously to work a bit with the supply chains that were still under some kind of reconstruction after what happened during the COVID time. What we've suddenly experienced was the war in Ukraine, which no one, as we are sitting here, expected. This is something which happened to all of us suddenly. In fact, we are all affected over what is going on because then we have three factors. We have a factor of still supply chains being affected and it's not really universal to the whole world. We have areas which have been more affected than others and treatment of COVID still differs from country to country and from the region to region. Then we've got this political turmoil which is going on and this is something which I think we all have to take into consideration when thinking about macro and what is going to happen. We've got interest rates through the conflict. We've got an inflation, and then through the inflation, we've got interest rates skyrocketing. We haven't seen those numbers, those percentages for the last 30, 40 years. This is something which is a huge issue for developing countries especially. We have a big issue with what is going on with hard currencies because they are appreciating a lot against developing currencies, which means that, in fact, at the end of the day, affects a lot what we are doing here as we are sitting, which means that all the projects in developing countries, in those regions, need to be considered more risky. We need to

think more about how to mitigate those risks together for different ways. Then at the end we have a factor of as prices went up and we have shortages of food all around the world. This is something which could cause a lot of social, and at the end of the day, political issues in many countries. There is plenty of factors that will definitely implicate that macro is not going to look as we would love to when we were entering 2022 a couple of months ago.

Deepesh Patel

For sure, thank you, and thanks for outlining some of those factors. Jérôme, what's your view given you sit within a lot of those industries and you can talk to a lot of those counterpoints? How's the market beared with some of these unprecedented challenges around the pieces Janusz mentioned: inflation, war, political risk, disruption of supply chains, et cetera?

Jérôme Pezé

Just to add to what rightly said, Janusz, I remember that in the fall of 2019, and we were together, remember it? There was a consensus within the credit insurers that there would be a potential change in this cycle due to the fact that the valuation of companies were excessive, the Shiller PE ratio was beyond 30, the depth was beyond $225 trillion, there were a number of trade disputes, the economies were growing asynchronously and there was a discussion regarding multilateral versus bilateral views. In between came COVID-19. We saw the impact of COVID-19, and then the war in Ukraine, and then we got the inflation and if you add all the elements which were identified in 2019 already, which already at that time, brought many private, notably, credit insurers, to adjust the capacity are still there. The depth is $320 trillion. The Shiller PE ratio, by the way, which went to 38 is today I think 30, which means valuations are still excessive. All those element prevail. One of them is interesting, the fact that during COVID-19, bankruptcies totally stopped with the massive flow of money in the economy. To give you a figure, the bankruptcies in Europe moved from 350,000 per year to less than 200,000, so we are going also to face the fact that there will be a catch-up effect. We are, in a sense, to a situation — and Janusz is right — close to the one of the year 73 with the oil crisis, with the cost of commodities, with the post-quantitative easing policies, with the geopolitical risks and the inflation surging, but also with that last element I mentioned. So indeed, credit insurers are today in a position where they are going to face an unprecedented level of uncertainty but they have accumulated also an unprecedented level of profit during the last 13 years with historically low level of claims. There are very likely to be alone that time to face the crisis, without massive government support. Reinsurance capacity was unlimited in the last years. It's going to be more scarce. Credit insurers cannot repeat what happened in 2000, 2009, and in the first semester of 2020 with this umbrella model. They will have to be clever, selective. Demand will surge from corporations, from banks, as well for solvency requirements, while the cost of risk will increase. The growing role of ECAs, which we saw in the last three, four years, will continue. Which means that there will be a need for credit insurers to be capable to also collaborate differently

between themselves, they will have to be more clever, and the demand, as I've mentioned, will in the same time significantly increase.

Deepesh Patel

Thank you very much, and yes, serious repercussions, from the states withdrawing their support to private businesses recently following what happened during the pandemic. Richard, do you echo this and what's happened from a claims and payouts perspective? But also, what do you think will happen from a claims and payouts perspective as a result of recent events?

Richard Wulff

Well, first of all, if you would have asked me this question two years ago, and to give you a prediction what the claims ratios would look like now, I would have been wildly off. We were expecting the worst, we got off the best. The claims environment has been extremely benign for the past two years, largely because of government support within the economy. Now, if we look into the future, it's all been said, inflationary pressures, geopolitical tensions, everything to do with commodities, what I see in prospects is very uneven. According to research done by our members, we see the global business insolvencies rebounding in 2022 by some 10%, next year by some 14%, somewhat dampened by state support, continued state support in France and Germany. On the other side of the spectrum, we see sharp rebounds in the UK, where we do expect insolvencies to go up pretty sharply and we're already seeing it. And in Asian countries where you see the number of trade debt outstanding, the number of days, going up steadily and steadily, and this will cause some stress in the whole supply chain because, not only does that show that liquidity is a little bit tighter, but it's like when you dance in a long line, if the start of the line varies a little bit, the end of the line varies a lot and that's what we're bracing ourselves for. What Janusz has also said, country risk is not behaving as it did over the past couple of years. If I look at my members, country risk downgrades outnumber upgrades by more than 10:1 at this moment. Yes, it has everything to do with the strength of the dollar. It has everything to do with commodity prices and it will have its repercussions on the claims ratio of my members.

Deepesh Patel

Thank you very much, Richard, I guess am picturing a dance train now with some wild people at the back. Gary, would you say risk appetite as a result then has moved up the credit curve? I'd love you to comment on the idea that the industry is supporting the best, the AAA, but I also ask, what's the result of that on companies that the industry would have previously supported, that might have been deemed a little bit more risky-- the BBs?

Gary Lowe

Yeah, there've absolutely been claims in the market. The data that Richard gave you there is really telling. In 2021, there were a billion dollars of claims paid out to banks just on the

structured credit side so not including short-term trade credit and public agency. It's a pretty meaningful number. There were some concentrated claims, particularly in Asia, particularly in the commodity and trader space, which has an impact. There were credit insurers who withdrew from this space or withdrew from the Singapore market in particular as a result of that. I think the reality is that for some of the smaller players who don't write a huge amount of premium to be able to absorb a single large loss, it simply didn't make sense in the context of one line of business amongst many, of course, there are the model lines who are working just in this credit space, but actually we work with a very broad range of insurers who are far more concerned about a hurricane in the Gulf of Mexico in terms of their overall balance sheet position if it were an equity event rather than just a P&L event than they are about credit. But nevertheless, any insurer loss to the market is keenly felt. We're therefore very happy when we look to new insurers. There have been new entrants into this market steadily over recent years. Look, I think claims are part of the business. If I look at my book that we run at Standard Chartered, we run a... As it happens, I've got a 30% loss ratio, which means insurers have made money out of doing our business. But it works for us too because of the benefit in terms of capital, returns, and risk management. I see some bumps in the road which have had an impact in terms of risk appetite, you're right. Insurers are now... Who traditionally have looked at investment-grade sovereign risk in difficult parts of the world, if we could put it that way, at least in terms of ratings, have now turned increasingly to developed markets, investment-grade real estate, top tier corporate transactions which are absolutely the staple of credit markets, and any banker who hears me talk about this is always astonished that real estate lending is exotic in the insurance world, well, it's not to anyone who's run a Western European or US credit book. But, look, diversification is clearly what insurers are looking for. I want to give you one example which hopefully answers your question about what can we do about this? So, Standard Chartered recently closed a transaction for a sub-Saharan African government -a billion dollar deal- I think it's CCC-rated. Really a difficult transaction to mobilise that level of private market capital. How did we do it? Well, there were multiple tranches, there was a facility where an entity - the World Bank - took a first loss exposure, and then an African development agency took a second loss. Then we, as the commercial banks, used the private market for a third loss tranche. Suddenly, you have a way of stacking the capital layers in a way which mobilises significantly more lending capability than we would have been in the past. Alongside that were a number of ECA facilities, which were supporting export of the physical goods that were required to build the project. It's an infrastructure water development project, so a great ESG credit. So there's a great example right there of multilaterals, ECAs, development agencies, private banks, private insurers coming together in a way that supported a borrower who may otherwise have struggled simply going to the bond market and issuing capital in a way that has been the go-to in the past. So, yeah, insurance have gone up the credit curve, but there is absolutely a way for those who need financing to do this and that's why it's great to get this group together, because we look at different parts of the world, generally, in our day jobs but there are times when it comes together in really quite powerful and I think spectacular ways.

Deepesh Patel

Thank you very much. I think innovation in the PXF space is absolutely key and really looking at those partnerships between international financial institutions like IFIs, multilaterals, export credit agencies, etc., is certainly the way forward versus a traditional going to the market and raising a bond. Janusz, can you delve into a little bit more into what the ECA market looks like right now, especially in light of the Russian-Ukraine conflict? Does that mean ECAs such as yours have really had to step up into gear and really support more as a result of what Gary, Jérôme, and Richard alluded to?

Janusz Władyczak

There is definitely a trend which I think we can spot on the market, and Gary already has mentioned it, which means among ECAs and all the market players, we see the willingness of cooperation and the willingness of mitigating the risk. Everyone wants to share the risk and that's what is really happening. During COVID times, we've seen much bigger exposure being taken on developed countries if we compare to developing countries - so developed against developing. Whereas nowadays, we hope the developing countries are going to pick up and I think, considering certain markets like Africa, Central Asia, Middle East, we see those markets coming back, which we are pretty happy about. Obviously there is a plenty of risk which we've already discussed it, but I think there is definitely a need of cooperation because the world became a bit more tricky, and we see especially ECAs not really being willing to acquire the whole risk on their own books. This is something which is a really nice trend and it's going to be followed for definitely a couple of years. In terms of Russia and Ukraine and Belarus because we need to still keep in our minds that Belarus is involved as well. What we are seeing, especially from our perspective, obviously our exporters as such, we've lost a pretty big chunk of our business. When we look at those three markets altogether in terms of, let's say, trade receivables, for Poland, more or less, it was a market which was slightly bigger, there was three countries that are slightly bigger than the export to Italy, which I think is top five of our destinations. Which obviously we need to cover that type of losses which are starting to occur. But at the same time we need to develop more business and I think this diversification which has been mentioned here is the key. So, first of all, we are looking into different regions, how we can encourage our companies to go there, to be involved at the beginning as suppliers, then maybe as EPC contractors at some stage. But at the same time we're looking towards, especially Ukraine, and trying to encourage other ECAs and companies just to be involved in, let's say, developing the country, rebuilding it at some stage when the war is going to finish. At the same time, we're trying to support the day-to-day business of our companies, so from mid of June, we are back with trade receivables insurance. So all the transactions up to two years, we're supporting all the LCs. We're trying to be on the market to help to gain liquidity for the Ukrainian companies, and at the same time, to help our companies to be back on those market because it's extremely important for them.

Deepesh Patel

Thank you very much, and good overview from all of you from a macroeconomic and trade credit insurance perspective.