Financial Insights
2019

Empower Results®

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Foreword – managing volatility

Stuart Lawson, CEO Aon's Credit Solutions – EMEA

Welcome to Financial Insights 2019.

It doesn't need me to remind you that we are facing a period of volatility in the world economy but, as Professor Trevor Williams says in his assessment of the 2019 global financial landscape in this whitepaper, we could be facing a 'sharper downturn' than that being forecast given the scale of the current slowdown. Professor Williams points to a fall off in world trade, a decline in equity prices in developed economies, a drop-in commodity prices (particularly oil and industrial metals), as well as geopolitical factors such as Brexit all having an impact on the global economy and casting a drag on future growth.

This uncertainty is increasingly becoming a concern to businesses as revealed in our latest research for Aon's next Global Risk Management Survey which has seen economic slowdown/slow recovery and cashflow/liquidity move into the top 10 risks our clients say they are facing.

Regulatory concerns

For financial institutions, there are additional regulatory concerns such as the progress of the PRA's consultation paper for Capital Requirements Regulation. When will the final Supervisory Statement be published and what will be the impact on financial institutions' capital modelling? Amidst all this uncertainty, financial institutions are increasingly looking to the insurance market for ways to help offset their risk while also helping them to develop new, innovative products.
The role of credit insurance, asset based lending and financial institutions trade finance are all further explored in this whitepaper.

Lower cost

Despite the gloomy economic weather, the part that insurance can play for financial institutions is proving to be a ray of sunshine. Take the cost of funding for example as banks increasingly realise it is becoming more cost effective to play off insurers' Solvency II cost of funding versus their own cost of capital under Basel III/IV.
Another positive trend we're seeing is for financial institutions to look at their insurance on a portfolio basis – rather than transactional – and finding ways of achieving capital relief and/or risk mitigation across the larger tranche of a portfolio rather than individual counter-parties.

Our mission

At Aon, we're committed to partnering with financial institutions to help them access the insurance market to develop risk transfer and consulting solutions; to both minimise their own risk and push innovation where ever possible to help them achieve sustainable growth. Part of that mission is also to keep you informed on some of the latest thinking in the market and I hope *Financial Insights 2019* – a collection of articles from the academic, legal, banking and insurance worlds – provides you with some food for thought.

I would particularly like to thank each author for contributing their time and expertise.

We will be exploring these themes further at our annual FI conference "**Credit Solutions for a New World**" on the 24 April at The Aon Centre, London. For further information on this event or to register please contact Lindsey Warrington

The global financial landscape in 2019 – greater volatility to be the new normal

Professor Trevor Williams, University of Derby

Global economic activity is slowing down. After peaking in 2017 post-crisis at an annual rate of about 3.8% (measured in purchasing power so adjusted to take account of inflation differences between countries), growth in 2019 looks like it will ease back to 3.5%. Such a pace will equal the post-recession low seen in 2012. Looking at global growth over the last 40 years (*see page 6,* **chart 1**), shows that a sharp deceleration in activity occurs every decade or so. On that basis, a sharper downturn than the one being forecast at some point in the next three years may be odds on, as the projected slowdown is not on a scale that matches that of the ten-year cycle.

Slowdown intensifies

Worryingly, the global slowdown has intensified since the second half of 2018. Output has slowed in the euro area. After averaging 0.7% per quarter in 2017, euro area growth was just 0.2% in Q4 2018, reflecting a sharp deceleration in Germany as its auto sector sales drop sharply. Growth in China eased back, from 1.7% a quarter in 2017 to 1.5% in Q4 2018. Recent data shows that US growth in the last few months has been decelerating. For Japan, economic output contracted by 0.6% in Q3 2018, while the pace of expansion eased in India and Russia during the year.

UK economic activity was recorded at 0.6% in Q3 2018, but preliminary figures show that its pace slowed to 0.3% in Q4. In its latest report, the Bank of England forecasts an expansion of just 0.2% in GDP in the first quarter of 2019 and 1.2% for the full year, down from a prediction of 1.9% as recently as November.

But the excellent news shown in the chart is that the world economy has not experienced an outright fall in growth at any time over the last 40 years. Even during the severe financial and economic crisis nine years ago, growth in China and India averaged over 6% a year, as their share of the world economy continued to rise. In short, as they are populous countries but poor, their potential for catching up with living standards in the advanced economies is immense and so they grow faster.

Nevertheless, the reasons for the slowdown currently underway in the world economy are clear, as is the reality that most regions and sectors are affected and hence the downside risks to activity and asset prices should be acknowledged.

Global trade slows

Growth in world trade has decelerated sharply. Partly driven by the trade dispute between the US and China and higher tariffs but also to a lesser extent the US dispute with Mexico and Canada, the pace of global trade has fallen to 2.8% a year in the quarter to November 2018 from a rate of 5% a year ago (*see page 6,* **chart 2**). Slower global growth also reflects a tighter policy stance in the US, with a reduction in the size of the Federal Reserve's balance sheet and a rise in short and long-term interest rates compared with the year earlier. Monetary policy was also tightened in China, as it reduced liquidity and targeted loose credit conditions in its financial sector.

As signs of weaker global growth have emerged, financial market sentiment and asset prices have been adversely affected. It is also the case that, in some instances, asset prices had reached levels that seemed inconsistent with the performance of the underlying economy, so even without the economic slowdown that has emerged a correction might have been forthcoming. Most of this overvaluation seems to have been in equity prices in advanced economies but bond yields have also been at lows that only exceptionally loose monetary policy could justify.

Impact on equities

Equity prices fell back sharply in advanced countries at the end of 2018 (*see page 7,* **chart 3**). In early 2019, though, some rebound has occurred as policymakers have retreated from the harsher rhetoric about policy used late last year, especially in the US. By contrast, equity prices in emerging economies have held up rather better, and some countries have even shown increased asset rises compared with a year ago.

Expectations about increases in central bank policy rates have eased back in line with weaker economic growth, and long term interest rates have also dropped back.

Commodity price trends

Oil prices have also responded to weaker economic expansion by dropping back by around 25% since the middle of last year. There has been a sharp easing of industrial metals prices, reflecting the slowing trend of global demand. Both of these commodity price trends will feed into lower inflation pressure. Supply factors may keep the price of oil higher than otherwise as production problems in Russia and Libya partly offset the softening in global demand.

Corporate bonds spreads have widened, reflecting the risk to the balance sheets of over geared companies in the face of slower growth for their products. It may also be the case that some asset sectors – particularly those that had high yields – were overbought, so now may be oversold though are indeed riskier. In that case, some widening of spreads may have occurred in any event.

Brexit risk

Throughout the year ahead, issues of trade uncertainty, and in the case of the UK Brexit uncertainty, allied with policy outcomes are likely to keep the pressure on asset prices, weigh on economic sentiment and so on investment trends. For the UK, the Bank of England is assuming a smooth transition to a new relationship with the EU; should that not materialise then risk to the currency and to short term financial asset prices may be to the downside. However, if the outcome is positive for financial markets, the central bank may have to tighten more than is currently expected, which may offset some of the upside for asset prices.

From the US to the euro area, to the UK and the emerging markets, financial markets will have plenty to ponder on over the year ahead. On the one hand, trade issues, the end of the fiscal loosening and the end of quantitative easing in the US, a reversal of the loose policy stance by the EU (as it sells bonds or the effect of no longer buying) and credit tightening in China and India, will likely keep financial markets on edge. On the other hand, outcomes which are interpreted as orderly and or predictable could see rallies in asset prices.

Volatility brings threat and opportunity

Whatever the outcome, there is an economic slowdown taking place, its intensity is uncertain, and there are many policy risks in a range of countries. Hence, the conclusion appears to be that the world financial landscape faces many uncertainties that may lead to higher levels of volatility than seen in recent years, more in line with the reality of greater policy uncertainty and consistent with wider spreads. With higher risk and volatility, however, may come more opportunity to achieve outsize returns.

Chart 1: A global slowdown is underway

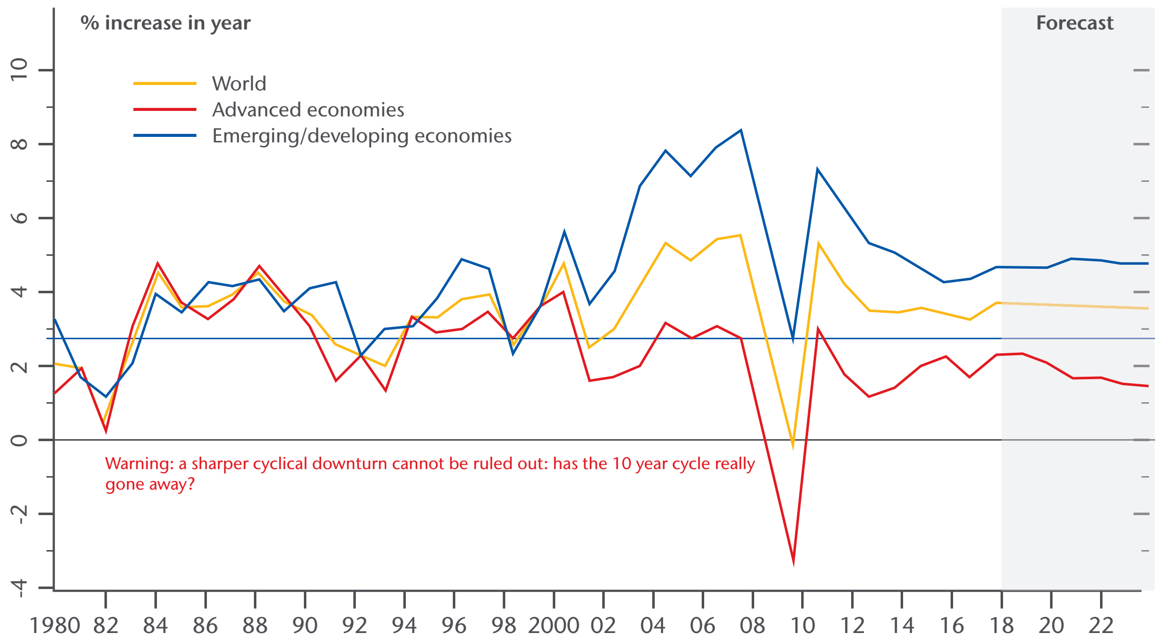


Chart 2: World trade in goods slides

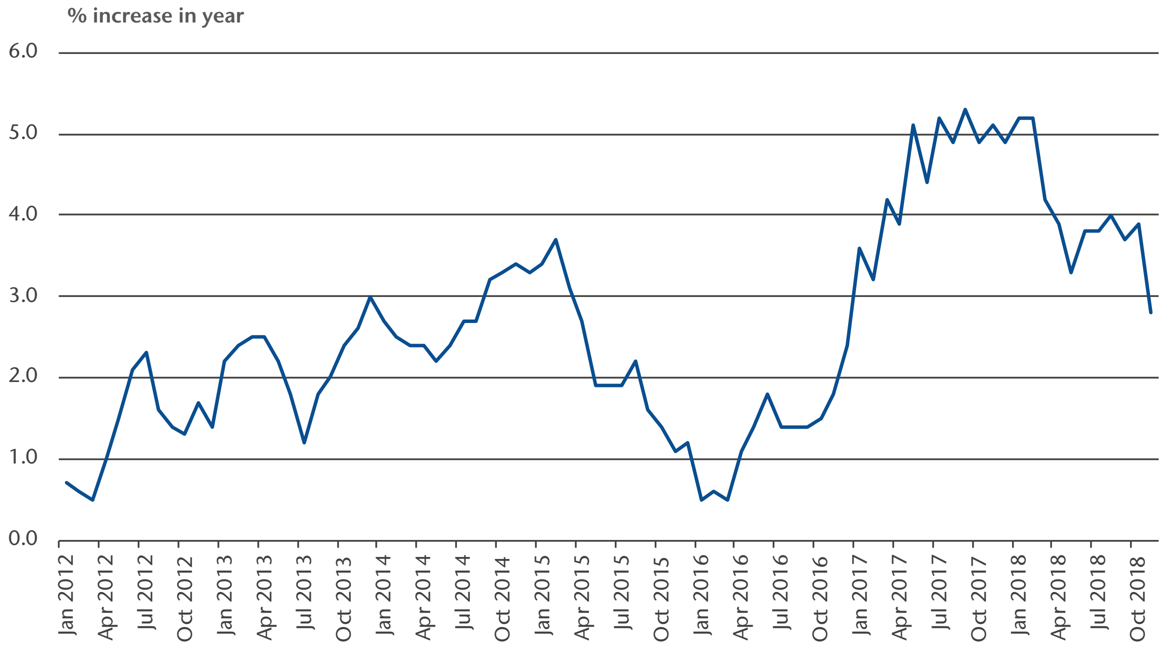
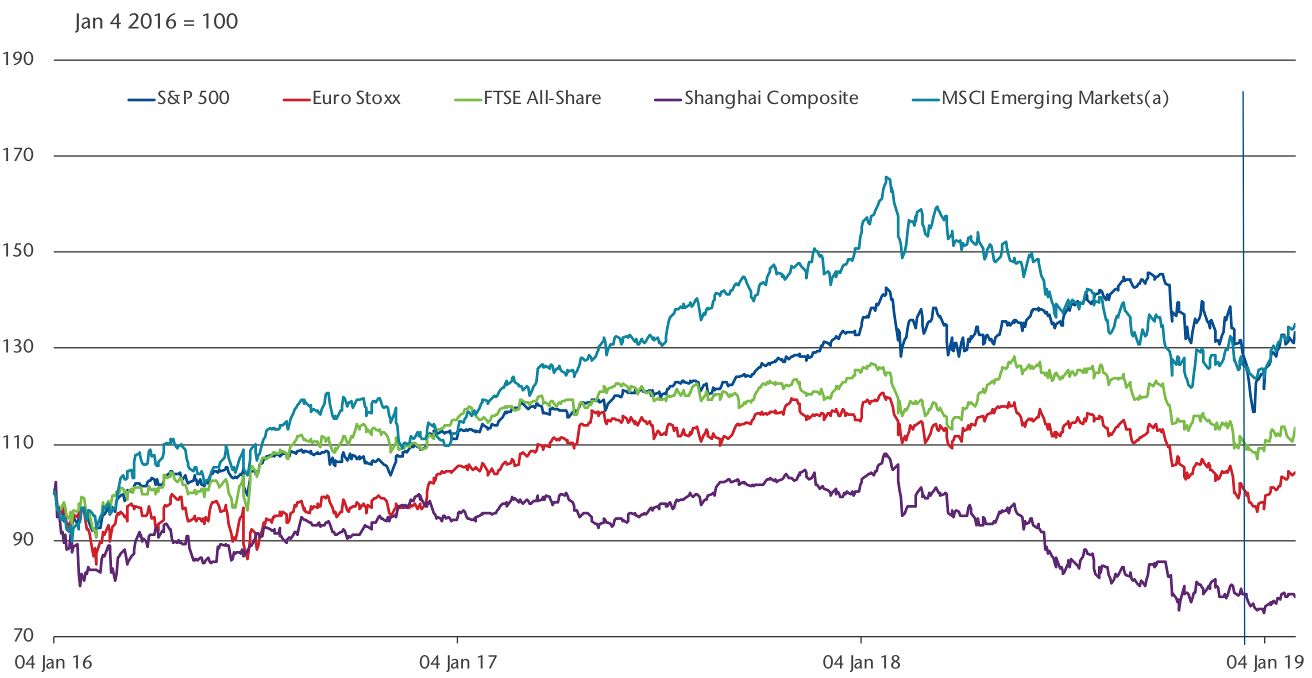


Chart 3: Global equity prices volatile



What is happening with the Capital Requirements Regulation?

An update on the PRA's consultation paper

Hannah Fearn, Managing Associate, Sullivan & Worcester UK LLP

In the first quarter of 2018, the UK's Prudential Regulation Authority (PRA) caused a stir by publishing a consultation paper regarding the eligibility of guarantees as unfunded credit protection for the purposes of calculating capital requirements under the Capital Requirements Regulation (575/2013) (CRR), under certain approaches[1].

Serious concerns

The proposals were the first meaningful guidance published by the PRA on its interpretation of the CRR eligibility criteria for guarantees, including non-payment insurance. Unfortunately, the consultation paper caused serious concern in the market for insurers and banks alike.

Key issues arising out of the consultation paper and relating to non-payment insurance included:

- The PRA's expectations that the provider of the credit protection must be obliged to pay the beneficiary bank "without delay and within days, but not weeks or months" of the counterparty's default, conflict with the typical waiting periods agreed in insurance policies.
- There is a lack of clarity as to whether policies containing market standard exclusions such as those relating to insolvency of the insured and nuclear-related events would be considered eligible, given that the operation of such exclusions is outside the strict control of the insured. In its draft guidance, the PRA appeared to remove any basis to adjust the value of a guarantee to reflect the bank's assessment of the impact of the limitations of coverage.

Reducing banks' ability to finance

When the consultation paper was issued, it was clear that if the PRA's draft Supervisory Statement was published in the form proposed, then the use of standard credit insurance policies for capital relief purposes would no longer be an option for certain banks. This would be despite the fact that such credit protection arrangements have an exemplary track record of paying out when required. This could seriously reduce banks' ability to finance transactions.

Consultation papers are used by the PRA to set out draft proposals and invite comments from the public. There appears to be little evidence of wide consultation by the PRA prior to publication of the draft guidance as to its potential impact, particularly in respect of the standard terms of insurance policies and the use of credit insurance by banks as part of their risk mitigation strategies. However, the PRA's published proposals were subject to a consultation period which closed on 16 May 2018. A number of industry bodies submitted responses to the consultation paper describing the use of non-payment insurance as credit risk mitigation and requesting changes to the proposed position taken by the PRA that would assist in the application of the CRR requirements. Some of these responses have been published and are available for review. It is likely that a number of institutions also submitted individual responses on a confidential basis.

At this stage it is not known when the final Supervisory Statement will be published, even though a year has elapsed since the draft was released. In January 2019, the PRA published a consultation paper regarding funded credit protection, suggesting that it is still actively looking at credit risk mitigation and the CRR requirements.

[1] *Credit risk mitigation: Eligibility of guarantees as unfunded credit protection" (CP6/18)*

Will insurers adjust terms?

It is hoped that the expectations of the PRA as set out in its consultation paper will change in the final Supervisory Statement in response to the robust feedback of the market. However, if the Supervisory Statement is not changed, it is open to insurers to adjust the terms of policies to meet the PRA's expectations. For example, insurers may agree to remove or revise problematic exclusions or shorten waiting periods. However, this will likely take some time to achieve, particularly as reinsurance contracts will need to be renegotiated. From an operational perspective, insurers may not be able to easily shorten waiting periods to a few days. This means there will potentially be a period of very limited capacity for banks affected by the PRA's proposals to be able to place CRR-compliant policies.

The PRA's Supervisory Statements are relevant to all firms bound by the CRR that are regulated by the PRA. For non-UK banks not regulated by the PRA, the PRA's expectations will have limited direct relevance, and those institutions will need to consider the views of their local regulators. Following Brexit, the PRA's views will have even less relevance to the interpretation of the CRR in the EU. When the UK leaves the EU, it is expected that the provisions of the CRR will be transposed into UK law and become part of the UK statute book (as EU regulations will no longer have binding effect under English law). As such, the PRA's Supervisory Statements and other published guidance on the CRR requirements applicable to credit risk mitigation will continue to be relevant to UK banks using non-payment insurance for capital relief purposes.

Receivables purchase and capital optimisation – market trends, challenges, benefits and why credit insurance is important

Jonathan Parfitt, Director Origination Corporate & Institutional Banking, ABN AMRO Asset Based Finance

The business environment is continuously changing, with increasing levels of regulation. This, combined with the need to manage and embrace new technology and complex supply chains, has meant that the role of the CFO and the treasury function in large international corporations has evolved. There is a greater need to focus on offering a broader vision as a strategic partner to the executive team and creating shareholder value. By implementing improvements in the working capital management strategy and related processes, this can provide additional support to the company's growth plans.

Capital optimisation has become a key discipline critical to the finance function and to be effective, the CFO needs to have a working capital management strategy which requires a detailed understanding of the main value drivers within the business.

Understanding the supply chains

As part of any working capital management project, a CFO will often undertake a 'business analysis' to understand both the physical and financial supply chains across trading transactions. This will identify gaps and allow a strategy to be formulated to align the stages requiring cash in the physical value chain, with stages in the financial value chain where cash becomes available. This assists the streamlining of key value drivers and related processes to maximise value.

From a financial point of view, the goal is to have sufficient cash available to settle current financial obligations, whilst minimising the cost of keeping excess cash available. The financial elements need to be structured around the physical value chain of the company. The key question in working capital management is how to (re-) balance the physical and financial value chain in such a way that an optimal contribution to shareholder value is realised?

Matching the physical with the financial

When it comes to the matching of the physical supply chain with the financial supply chain, the CFO will be working with a range of products provided by a banking group. This includes, trade and supplier finance, as well as financing of inventory and receivables. The finance team will ensure it has sufficient market knowledge and understanding of the products available both inside and outside of its banking group, whilst maintaining a wide enough group to avoid having too much reliance on any one bank. This has to be balanced with the need to keep the members of the banking group satisfied, so each has a continuing interest to support the relationship. The skill is in securing as many applicable products to maximise working capital efficiency, maintaining and managing the supply chain, and ensuring there is sufficient headroom to support growth, at a cost that maximises shareholder returns.

Another CFO goal will be to create incentives and therefore further value through the optimisation of working capital. This is approached firstly with an analysis of financial ratios and cashflow, but also through implementing changes to improve working capital management, for the company. Measuring performance and targeting improvement through metrics creates a shift in the mindset to focus on value creation. Indices such as 'cash management', 'accounts receivables and payables management' as well as 'inventory management', lead to a quicker cash conversion cycle, improving overall efficiency and the availability of resources, increasing profitability, as well as helping to maintain a good relationship with key suppliers.

Shortening outstanding periods

Improving the accounts receivables process and shortening the outstanding period can be achieved through having good processes, i.e. sending out invoices quickly, ensuring they are accurate and managing a timely collection process which can improve the days sales outstanding (DSO). For large corporates a one or two day improvement in the DSO can make a significant difference in cash terms, but it is important that any improvement is sustainable and can be maintained or the benefits can be quickly lost.

CFOs will also want to review credit terms with the company management to ensure that the level of credit being offered to debtors is appropriate in respect of both the risk and reward, especially for key customers. But maintaining a low DSO, although good for the metrics, can sometimes work against the business by restricting opportunities for growth and therefore returns. The CFO will want to balance the need to control credit with the commercial reality that customers are often looking to optimise their own cash and profit by seeking longer terms, or at least receiving discounts when paying more quickly. If extended credit terms can be granted, an incentive is created for customers to purchase more product at possibly better pricing. If the customer is creditworthy then, from a risk perspective, the CFO may be satisfied to allow more credit, but will be aware of the impact on cash – this must constantly be weighed up.

Turning to receivables purchase as a finance product

Selling receivables on a non-recourse basis has been a widely used way of providing working capital to large corporates in Europe. In the UK however, receivables financing has historically been mainly provided to SMEs through invoice discounting companies offering finance on a recourse basis, with security registered accordingly. Financing receivables for large corporates has usually been provided through securitisation programmes by banks, where billions of receivables are purchased annually on a non-recourse basis. The risk is mitigated by writing individual limits on buyer names or through credit insurance.

Receivables purchase is a product increasingly recognised as a valuable tool to support the financial value chain and working capital management. Not only does it release the existing value tied up in trade debtors, but it can also be used to ease many of the CFO's challenges mentioned when weighing up opportunity cost, without the pains and limitations of setting up securitisation. The key benefits of receivables purchase are:

- By having the ability to sell receivables immediately, it reduces the need for the corporate to hold excess cash, whilst still protecting liquidity.
- As it is usually structured on an uncommitted basis, this makes it very flexible and available to use as and when required. Receivables can be sold as often as needed to support growth, seasonality and acquisition. For the same reason it also becomes a cost effective product.
- With no requirement for security, it can sit alongside other core banking products such as revolving credit facility (RCF), bond, existing securitisation or supply chain, to provide additional flexibility and protect headroom.
- It can be used to transfer risk and therefore improve capacity, allowing internal credit limits to be maintained whilst ensuring more product can be sold. It can also allow extended credit terms to be offered.
- Being very easy and quick to arrange, implement and operate, it does not take up valuable resources within the finance function.

Credit insurance supporting receivables purchase

In many cases, conditions set under core bank facilities, RCF will allow baskets of receivables to be financed. However, terms will most likely require the purchase to be on a non-recourse basis. For this to be achieved, when selling receivables, the corporate must transfer substantially all of the risk and rewards to the purchaser (bank/financier). By the purchaser accepting default and insolvency risk on the debtor, a true sale of the receivable is achieved and the facility can therefore be structured on a non-recourse basis.

This requirement can restrict the solution to receivables owed by debtors considered by the purchaser to be undoubtedly creditworthy (usually investment grade) which sets its own internal limits. This can work well if there is a concentration into a single or a few strong customers, but is less effective against a large, well spread portfolio.

A tried and tested solution allowing a much greater number of debtors and therefore receivables to be included, is to credit insure the outstanding and future sales ledger. This provides the purchaser with a risk mitigant and multiple limits, which it can then set internally to control the level of purchase. It can be achieved in two main ways; either by the corporate taking out and managing its own credit insurance policy, under which the purchaser becomes joined to the policy; or for the purchaser to re-insure the risk through its own policy. Both work similarly in practice although the obligations on the seller vary.

Choosing the right credit insurer is key to this operating smoothly, ensuring there is the capacity to provide the required limits and at the right cost. An additional mitigant to this structure is where the insurer is prepared to grant non-cancellable limits which by definition bring greater certainty of the products' effectiveness.

Depending upon the size of the facility, it is possibly more cost effective for the purchaser to insure the receivables, as it may be in a position to achieve better pricing as part of a much larger book.

What other factors are important?

CFOs, when looking to create efficiency, are usually sensitive to the workload created when entering into and operating any new financing facility. Choosing a lender with the necessary systems to run large, comprehensive programmes on an automated basis is important; to avoid limitations and to ensure transparency of receivables purchased. This is fundamental for all parties when operating a successful receivables purchase solution.

International groups will also want to take advantage of selling receivables to and from growing businesses or subsidiaries abroad. However, finance can be limited for businesses that trade internationally, as many banks will only lend to businesses that trade in their home market. It can be costly to set up bilateral facilities across multiple territories and the solution can be fragmented and inefficient to manage. Some larger groups will have a subsidiary (captive) in place to act as a finance company and as a direct insurer, or reinsurer to purchase receivables internally and then use existing bank facilities in their home market to provide the funding.

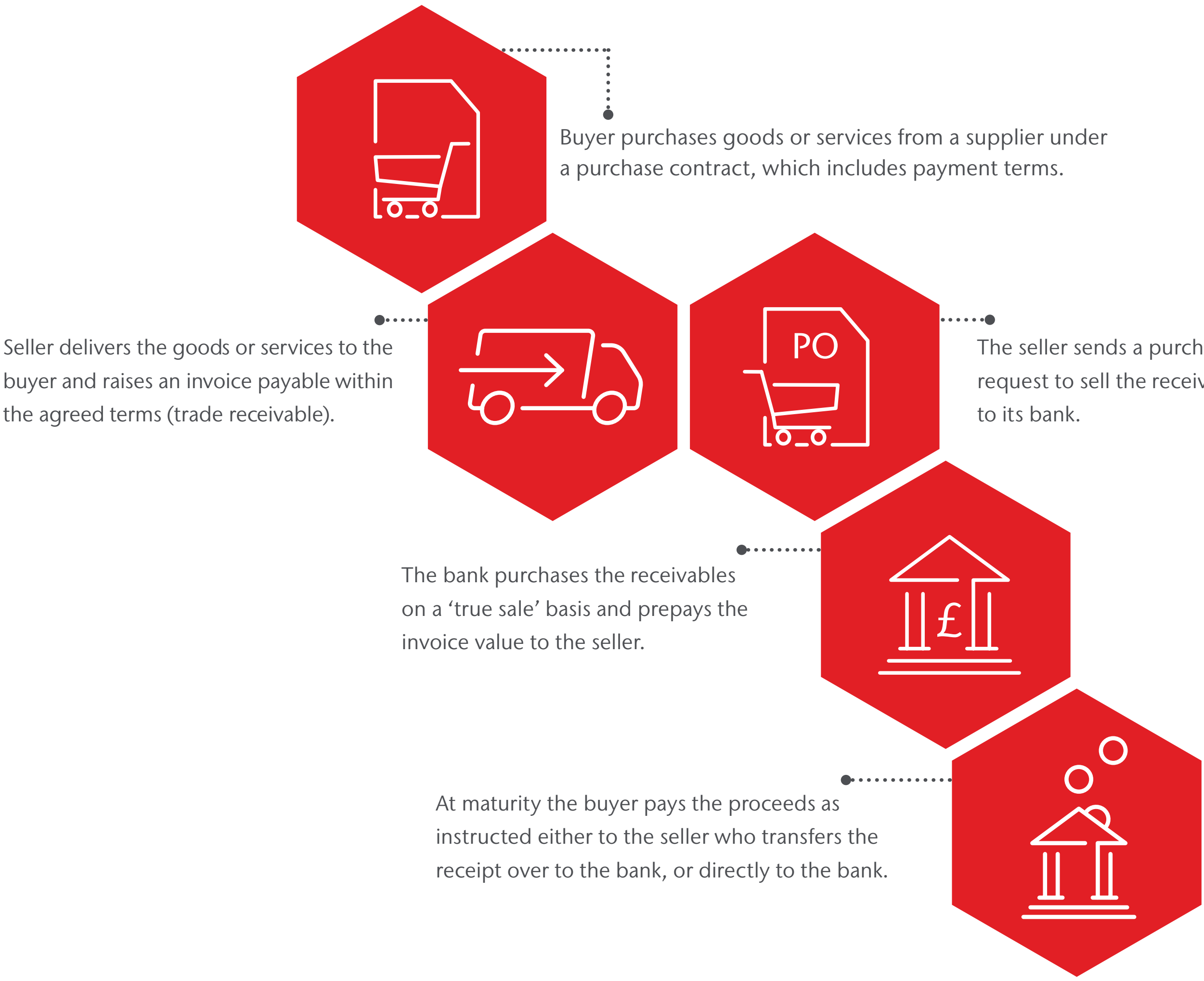
Set up a single group facility

Another proven solution is to set up a single group facility which allows the receivables of European operating companies to be sold to a non-trading 'quasi SPV', which is bankruptcy remote.
Finance can then be provided to the 'quasi SPV'.

The benefits of this include; one loan contract, single source of funding, consolidated cash pooling and availability, and consolidated covenants which leads to operational efficiency. Also new operating companies can easily accede to the facility in the future, which is important for acquisitive groups.

Realistically most lenders are only able to offer part of the required solution, but by appointing a single agent and working together across the bank group, the corporate has a better chance of including a greater number of its trading territories.

Receivables Purchase Facility



Perspectives and insights on asset based lending

Jeremy C Harrison, Commercial Finance Association Europe – President

I remember writing a dissertation for my degree thesis on factoring and invoice discounting and comparing the two types of financing. The plan was that this would lead to a career and that is exactly what happened. Initially joining BNY, which rapidly became GMAC, the path then led me to GE, Lloyds and latterly at Bank of America. I was also fortunate to work in the UK, Dublin and New York during this period.

My original perception was that invoice discounting would replace factoring and that asset based lending (ABL) would eventually take over both. What has become clear is that whilst receivables financing dominates ABL, even if you are a global ABL player, all three derivatives of receivables financing are important in their own way.

Receivables financing dominates ABL

Receivables financing is likely to continue to dominate ABL in the future as clients continue to look for easy to use solutions, with their prime drivers being the desire to benefit from AI/digitisation and to also mitigate risk from an operational perspective. This solution sometimes needs to be off balance sheet in order not to affect leverage in leveraged buyout (LBO) situations, and to allow for the carve out of receivables under the LBO deal documentation which requires strict criteria to be adhered to.

> "Year on year more clients/companies use ABL and recognise the benefits and protections it affords".
> ***Various advisors***

This has inevitably led to a boom in credit insured receivables purchase arrangements which I expect to be a trend in 2019 onwards, particularly as we continue to experience global economic disruption.

> "Clients want a reasonable cost funding solution, which is easy to use, off balance sheet and committed." ***Advisor|Company***

Where ABL is the principal source of funding, lending can easily be extended to other assets (inventory, plant and machinery, property) dependent upon jurisdictions, which we see as a continuing trend. But where the lending is bifurcated with a second lien or another term specialist lender (lending funds), the other assets (non -working capital) may be needed as collateral for that lending, so not available for the ABL.

Every year the ABL sector introduces new clients and this trend has continued as knowledge and the efficiency of ABL as a funding option is recognised, which the teaming up with lending funds can only further reinforce.

Taking a broader view

Of particular note is the desire by companies seeking innovative solutions in this complex world. I remember one global company telling me that they were involved in 28 countries in Europe and operated facilities with over 30 banks. Over time the company wanted to reduce its lenders to a handful of banks which would require banks lending against receivables in more than one country. This of course limits the number of banks who can help. Credit insurance however is a key mitigant and this can enable a bank to take a broader picture view of the receivables.

There are other structural options including selling receivables to an SPV or re-billing to an entity in the certain proven jurisdictions. We have seen entities in the UK, Isle of Man or Ireland, the Netherlands and Switzerland used for this process.

As I have already mentioned most LBO structured facilities are structured where there is a carve out for receivables. Quite often the term factoring is used, but latterly receivables financing (or purchase) is being used too. This gives ABL an opportunity to penetrate this market but as the requirement criteria includes off balance sheet treatment, funders will look for mitigation and I see this too as an opportunity for credit insurance growth.

Continuing to provide funding

We have a positive outlook for the ABL sector despite the troubled global environment because ABL has always, and will continue to, provide funding in unsettled economic conditions. The wish is that we as a sector continue to innovate, working with funds and providing our clients with bespoke solutions, including other assets, to match their needs. This will also deliver an opportunity for the credit insurance sector, advisors and lending funds.

Growth of FI open account trade

Mirka Skrzypczak, Head of Trade Finance and Working Capital Product, NatWest

What do we mean by FI trade finance?

FI trade finance is where a bank provides direct or indirect financing to a financial institution which, in turn, funds the provision of credit facilities by the bank's FI clients to their corporate customers against trade instruments. This structure is symbiotic as it provides a greater selection of financing options to the corporate customer, whilst also allowing banks to access jurisdictions where they do not have a physical presence, such as European and North American banks in Asia.

Open account trade is fast becoming the trade finance tool of preference

Over the past decade there has been an acceleration and expansion of open account trade, namely supply chain finance (SCF), across all key markets. SCF is a more complete trade financing solution than traditional trade instruments as it provides a trio of benefits to both buyer and supplier in a transaction:

- SCF increases the liquidity made available to suppliers by advancing funds to them as soon as the buyer approves their invoice, thus improving their cash conversion and providing a vital flow of funds.
- There is a credit arbitrage opportunity, whereby a lesser rated supplier can receive payment at a discount rate commensurate to a higher credit quality counterparty.
- The facility can be structured to provide off balance sheet benefit to the buyer.

SCF is a more technology reliant financing solution than traditional trade instruments. This had historically proven to be a barrier to entry for smaller clients however, with the advent of cloud computing, distributed ledger technology (DLT) and APIs, allowing information to be more easily shared, there is significant potential to expand SCF from its traditional client base of large corporates into the mid-market. One such open account solution is Marco Polo, where a consortium of banks, including NatWest, are working with companies such as R3 and TradeIX, to deliver a SCF financing tool on Corda DLT.

What challenges are there in structuring FI SCF transactions?

Post the 2007 financial crisis, UK and European banks have been required to ring fence their less risky retail and corporate banking from their risk taking investment banking activities. Advancing funds to an FI is considered by the various regulators to be an unacceptable risk to hold within the ring fenced bank. This poses many banks a problem; their key deposit base and thus liquidity is within the ring fence, so would be reliant on more expensive wholesale funding for any lending to FIs made outside the ring fence. In addition to this, bank capital models have been designed to be prudent post crisis, therefore the potential 'double default' scenario of FI trade increases the amount of capital a bank is required to set aside for such a transaction.

How can trade credit insurance (TCI) assist?

TCI brings a multitude of benefits to all parties: bank, FI and its underlying corporate. Primarily this relates to the provision of a facility by the bank as without this facility, it may not be possible to finance the underlying trade. The key benefit to the bank is that by sharing risk with an insurer it may allow a transaction that there is credit appetite for but would not have previously met internal return constraints to hurdle. This materialises both in the form of a reduction of capital requirements and reducing exposure on single names where there is a concentration risk. In many instances, TCI is the difference between being able to execute a transaction and not, and therefore is absolutely vital to the underlying flow of trade for the corporate.

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Published by Aon UK Limited

Registered office The Aon Centre, The Leadenhall Building, 122 Leadenhall Street, London, EC3 4AN

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This publication has been compiled using information available to us up to February 2019.

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