

Trade Safe: Episode 1

SANJEEV GANJOO: I'm pretty quite optimistic that next decade may be a transformational period for receivable financing in the industry.

SCOTT PALES: Oh, it's exciting.

SANJEEV GANJOO: Yeah.

SPEAKER 1: Welcome to Trade Safe, a podcast series for trade credit professionals where WTW experts talk with industry colleagues on how organizations across all industry sectors can manage trade credit risks safely.

SCOTT PALES: Welcome to our first podcast in the Trade Safe series of podcasts, where we're going to be discussing various topics involving trade credit insured account receivable financing. I'm your host, Scott Pales. I'm with Willis Towers Watson's Financial Solutions Trade Credit Practice. And with me is my partner Sanjeev Gangoo, who is the Head of Global Financing for Citibank. Welcome, Sanjeev.

SANJEEV GANJOO: Good morning, Scott.

SCOTT PALES: Good morning. So Sanjeev, from your chair as the global head of the AR financing, what are some of the priorities that you're seeing and hearing from your corporate clients with regard to credit insured AR financing? And I think more importantly are you experiencing any shift in their priorities from a pre-pandemic to a post-pandemic basis?

SANJEEV GANJOO: Sure, Scott. First of all, a big thank you for inviting me to this podcast series. I am really excited participating in the series of podcasts on this specific topic.

SCOTT PALES: You're welcome.

SANJEEV GANJOO: Thank you so much. Now, in terms of the trend and the changing priority, even with the shifting of supply chains globally, ongoing trade tariff negotiations, which have been going on the past couple of years, or whether it's from the increasing shipping cost or the current pandemic environment, what we are seeing is that many corporates are looking beyond their home countries for business growth. Hence the cross-border flows appear to be increasing, which can lead to corporates looking for means to help and protect and mitigate the risk by exploring solutions to help secure their data books internationally.

And also clearly, the portfolio based approach appears to be gaining much more relevance in the current environment, with the mix of debtors locally, regionally, and globally. And the same thing, if we have to take a couple of years back, it was more like a bilateral based approach. But now with how the things are evolving the past couple of years the portfolio based approach has been gaining much more relevance today.

And clearly, the key performance indicators for the treasurer's or the CFOs appear to be changing as well, as now they are being benchmarked against the receivables turnover ratio that is, how effectively they are able to monetise receivables for either for risk reasons or for effective balance sheet management.

SCOTT PALES: So Sanjeev, Sanjeev, you're seeing the RTR, receivable turnover ratio investigations, you're seeing those being conducted differently post-pandemic than pre-pandemic?

SANJEEV GANJOO: Absolutely. Absolutely. You know as I was saying, that what I'm seeing is that nowadays investors are analyzing companies as well as how effectively they are able to monetise or to churn these receivables from the balance sheet, right? So it is becoming very, very key indicative for the investors as well.

Going back to the corporates now when we talk of their entire portfolios, corporates are indeed now looking for financial institutions who can not only cover their debtors locally, but globally as well. And especially with those having strong connections with the leading global players in the insurance industries. And why I mentioned insurances is, gone are the days when your bank was very comfortable doing a cherry picking and doing more of a bilateral based approach.

But now since as things evolve, companies are looking to defease their entire portfolio of receivables rather than doing a cherry picking discussions with the banks. So hence it's very important for the banks to have that sort of connectivity with the insurance players globally as well.

SCOTT PALES: Yeah, this is a good segue then into our main topic, and specifically the tsunami wave of insolvencies. So we were expecting this in 2020 as a result of the pandemic. And then we thought, well for sure we're going to see this wave of insolvencies come through in 2021 and did not. So is this tsunami wave of insolvencies still to come as a result of this pandemic? What are your thoughts?

SANJEEV GANJOO: Yeah in my personal opinion we should expect insolvencies to go up substantially this year. And the reason for that is very simple. Past two years, we have seen tremendous stimulus being provided from the various government to support their ecosystems or their economies globally, right. And US alone for that matter supported close to over \$3 trillion during the pandemic environment. Now, as countries keep coming out of pandemic, it's quite natural the government support should start tapering off. And this could adversely impact many small and medium sized enterprises of the world. And hence it is quite logical to think that we should expect increase in insolvencies. And link to that, I feel there will be a big jump on the claim process as well for the insurances.

And let's not forget there were many small and medium sized enterprises who entered in the business last couple of years just to cash on the opportunities during the pandemic on the back of the government support, which was available. And again, linking it to the changing economy right now with the general environment, liquidity is indeed getting pulled out. It is not that freely available what it used to be.

And then we are expecting interest rates to go up as well, which can, again, be a dampener for these small and medium sized enterprises. So I think this is an [INAUDIBLE] train what we are seeing, the majority of impact should be on the small and medium sized enterprises, but not the large part to that extent. And going by some of the public reports, which I was reading last week and the insolvencies in some of the European markets have already started ticking upwards.

So it's going to be a quite interesting year to see how the insolvencies unfold. But then Scott, again flipping the question back to you, since you are more involved having a daily negotiation with most of the insurers globally. So what are credit insurance underwriting thinking with regard to the wave of insolvencies which might hit this year?

SCOTT PALES: Yeah so this is the big question at the moment. So I did petition two of our largest trade credit insurers, Euler Hermes and Atradius. And for Euler, their VP and Regional Director for Information and Grading and their Head of Sensitive Risk Unit, Stephen Georgetti. Look this is a guy who's on the front line for this. He's basically come back and said, correct, this is the big question at the moment.

And, Sanjeev, just like you had just mentioned, they're already seeing insolvencies pick up in certain pockets of the world. So they look from December of '21 compared to December of 2019, insolvencies are up 33% in the UK. So they're definitely seeing insolvencies on the rise. And they're echoing realistically the same comments you just made, which basically are it's hard to imagine the governmental support continuing in the way it had been.

And so the typical expectation or the normal expectation is then insolvencies are going to increase. But what really interesting piece of information he gave me is that the share of what they term zombie companies, this is what they're watching and this is what they're showing significantly increase as well. And by zombie company what they mean are those companies that can only serve their interest expense and they're not making profit.

So these are the companies that are going to be most susceptible to these risks, especially in light of the looming interest rate hikes that are going to be put forward by the Fed. I think we're expecting these next month. And so we also had these exact same comments echoed by a Atradius. There, Jon Handen, BP of Special Products for the Americas, basically echoed the exact same comments that Euler Hermes put forward.

But he also offered that rising inflation and increased interest rates are absolutely going to create struggles for these companies, so higher financing costs. And then he also mentioned the additional debt that these companies absorbed during the pandemic. This is going to be tough due to the higher financing costs for these companies to weather.

So they're definitely seeing from an insurance perspective, that there will be an increase in insolvencies for this year. So this kind of turns us to the next question. If we're expecting higher degrees of insolvency to kick off for 2022, Sanjeev, what sectors do you see as continuing to be good targets for AR financing? SANJEEV GANJOO: Yeah, while some of the sectors like transportation, airlines, and travel, I think they will still remain impacted.

SCOTT PALES: Yeah, I think so too.

SANJEEV GANJOO: Yeah, and I think many sectors like oil and gas, chemicals, and to some extent the fast moving consumer goods companies seem to be coming back in demand for a portfolio based receivable financial solutions. And as for the performance of these sectors are concerned, there appears to be some sort of a positive outlook, which I'm sure many insurers are also witnessing. And hence, we may see the interest from insurers as well to these sectors coming back.

And besides we are also seeing increased interest from the insurers on the companies supporting tech digital infrastructure with 5G's getting rolled out in several leading economies. And the tech companies, I believe they have been sort of insulated from the impact of pandemic. It still continues to be a favorite spot for the insurers.

And to answer your second question on the pricing, as far as pricing behavior is concerned, it could be a two way strategy for the insurers, I think so. While at one side, they may wish to start building up good quality assets which would be under immense price competition as a protection cover against a possible claim environment which might hit this year. But

On the other side we might see increased pricing on small and medium sized enterprise portfolio pools in the countries where we might affect some sort of cross-border events or insolvencies to pick up this year. So in summary, Scott, you know my feeling is from the bank perspective, it's a rule we follow here internally as well, I think it will come down to the basic rules of risk versus return.

But, Scott, again coming back to you, what are insurers now saying about these pandemic affected sectors?

SCOTT PALES: So I did petition Euler and Atradius on this topic as well, talk about pricing and appetite. And Euler came back and said, there really aren't geographic considerations when they're looking at this from a sectoral basis. But they are seeing increases in their PDR. And this is what they're using as their gauge for sectoral analysis.

And PDR is past due reporting. So under trade credit policies, when receivables exceed thresholds for past due balances they must be reported to the insurer. And of course the insurers keep track of this data. Yeah yeah, it's going to be a precursor to future claim activity.

So here are some really interesting pieces of information from Euler in terms of hot spots from a sector basis. So we're comparing December of 2020 to this last December of 2021. And transportation is up 269% from a past due reporting basis.

SANJEEV GANJOO: That's a big jump.

SCOTT PALES: That's a big jump. Electronics up 227%, automotive suppliers up 138%, transport equipment up 113%. So based on these PDR values or past due reporting values, we can anticipate that specifically at least for these sectors, we should see a higher tick up.

Now Atradius comes back and maybe perhaps, I think interestingly, they look for the bright spot here. They said while there have been definitely sectors impacted, some sectors have performed quite well. And this kind of echoes the comments you made earlier as well. For IT, when they saw the demand for home office products and connectivity related devices skyrocket. I know I'm working from home or on a hybrid basis between home and the office. So as most of the world transitioned to home environments that IT sector has literally skyrocketed.

So that was a good bright spot. But on the opposite end, sectors like consumer durables, transport, aviation, and they say to a lesser extent metals, that these were inversely impacted. So they also came back and they gave a piece of information that I really found interesting.

They've said risk appetite has improved from their side as they've gotten adapted to this new environment. And their exposure levels are back to a pre-pandemic basis. And they also mentioned that from a pricing perspective, they've seen a stabilization in rates and this is now back to basically a pre-pandemic basis.

But unlike Euler's comment, Atradius is closely monitoring a couple of countries right now. They're really looking at Turkey, following the devaluation of the lira. They're looking at Russia and Ukraine, due to those rising tensions. And for Brazil, they're looking at the anticipated presidential elections.

So all in all, when we look at the insurers they're expecting higher degree of claim. But from an appetite and a pricing basis, we're seeing them advised that they're back to a pre-pandemic basis. So that's their generalized outlook. Sanjeev, what's your outlook for 2022 on the use of corporate AR financing? And more importantly, do you think there's a link in terms of what you're currently seeing from these corporates due to the expectation for higher insolvency?

SANJEEV GANJOO: Yeah, I believe the insurers are going to be very cautiously optimistic for this year.

SCOTT PALES: I like those words. I like those words.

SANJEEV GANJOO: Because as we have seen increased flows during the second half of the last year, and I would expect the same deal flow would continue during the first half as well, as corporates seem to be rushing to secure their debtor books. Now if you look from what is happening at a global trade

perspective they are the global GDP is expected to grow by at least 2 and 1/2% to 3% this year. And this would easily translate into increased trade flows as well.

And from the industry perspective, with global trade volumes expected to be over \$25 trillion and receivables is a very small portion of around \$3 trillion. So I'm pretty quite optimistic that next decade may be a transformational period for receivable finance in the industry.

SCOTT PALES: Yeah, it's exciting.

SANJEEV GANJOO: Yeah, and further have recently seen there's been changing landscape of for the receivable finance in many countries globally. So that might also add and might open the floodgates for the trade insurance industry. Also recently there have been-- we have seen a huge infrastructure spending by some of the leading companies like US and South Asian markets which could bring out substantial opportunities in those supply chains as well.

And one of the big segments is the renewable energy. And we are seeing a lot nowadays about renewable energy. Now this is again renewable energy is indeed a big focus by many governments for the next decade. So I think overall there are many industries like agri, oil and gas, and retail, which could also be an interesting sectors to watch as things unfold.

And lastly, I believe there will be some level of caution in view of the developing geopolitical events in some region, which might have an impact on trade flows as well. So I'm sure insurers are indeed watching very closely has some of the geopolitical developments unfold.

SCOTT PALES: I would say I would say, Sanjeev, that your outlook can be summarized in kind of two words, cautiously optimistic. I really like those words.

SANJEEV GANJOO: Absolutely. Absolutely.

SCOTT PALES: And I would say as a takeaway for our listeners that the insurance industry is also going to be in this cautiously optimistic basis. . They're noting that they're going to see insolvencies increase but they're seeing their appetites now return to pre-pandemic levels. So I think those are really good, really good, closing words, cautiously optimistic. So thank you, Sanjeev. Thank you for joining us today.

SANJEEV GANJOO: Thanks, Scott, it's a pleasure. Thank you very much for having me here and really thanks to the audience for listening to the podcast series. And look forward to participating in many more podcast series with yourself. Thank you.

SCOTT PALES: Yes, indeed. And again thanks to the audience for listening. And do invite the audience to listen for our next topic in this series, where Sanjeev and I are going to dig in a bit deeper on the changes in client behavior. Specifically we're going to look at some of the reasons why there may now be greater acceptance of insurance within these funding programs.

So until next time, trade safe and be well.

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