The Trade Credit Insurers' Guide - Construction

The UK insurance and long-term savings market and the ABI

The ABI is the voice of the UK's world-leading insurance and long-term savings industry, which is the largest sector in Europe and the third largest in the world. We represent more than 300 firms within our membership, including most household names and specialist providers, providing peace of mind to customers across the UK.

We are a purpose-led organisation: Together, driving change to protect and build a thriving society. On behalf of our members, we work closely with the UK's governments, HM Treasury, regulators, consumer organisations and NGOs, to help ensure that our industry is trusted by customers, is invested in people and planet, and can drive growth and innovation through an effective market.

Overview

This guidance is for businesses in the construction sector. It covers what is important for insurers to see. It includes what to do and not to do, as well as why trade credit can be so important to a business, and some of the recent wider issues in construction. This set of information was gathered from the ABI Trade Credit Insurance Committee Members.

Insurers are supporting construction

Insurers are looking to work with and support their customers. ABI data shows that 2023 was an elevated year of insolvencies, with 19% insolvency rates in construction. Yet the amount of trade credit insurance coverage approved on construction buyers as of the end of the first half of 2023 was over £29.6bn and the number of claims paid and reserved on construction buyers was £76.5 million. While we have also yet to see the full impact of the high-profile Buckingham Group insolvency, the additional anticipated claims paid could total over £30m, a lifeline for businesses that were affected.

Why do businesses have Trade Credit Insurance?

If you are the construction company with trade credit, it:

- *Provides ultimate balance sheet protection*
- *Supports your growth with creditworthy customers*
- *Reduces risk when trading with new customers*
- *Increases knowledge of your customers*
- *Enhances credit management*
- *Improves funding opportunities*
- *Optional debt collection service*

If your client is the construction company with trade credit, e.g. if you are a supplier to a construction company, it:

- *Reduces chance of insolvency*
- *Reduces disruption to project*
- *Improves ability to offer credit terms*
- *Provides an independent view on credit limit*

What are insurers looking for?

No construction contractor can avoid having some contracts that end up losing money. When economic conditions are tough, these losses become even more significant. Insurance companies don't just cancel coverage because of individual losses, they look at how those losses affect your financial health and ability to pay bills.

In a tough business environment, it is absolutely vital for insurers to have visibility of your latest financial results. This means not just the latest filed statutory results, but contemporary management information (MI). Over the past 10-15 years the level of buy in to providing MI across the UK as a whole has improved, but there is still a big difference in what companies provide. Even large businesses, with turnovers surpassing £50m, insurers often receive only summarized Profit and Loss (P&L) and Balance Sheet information. This, whilst helpful, can still be insufficient to address the questions which caused the insurer to make contact in the first place. In an ideal world insurers would be hoping for the following:

- P&L
- Balance Sheet including full breakdown of creditors / debtors / debt / WIP etc
- Cash Flow statement
- Profit & Cash Flow forecasts for the coming year
- Management commentary around any specific issues / pertinent points

Management commentary and forecasts, particularly cash flow projections, are crucial. Despite significant losses, insurers might see potential for recovery if the business can adequately demonstrate that they have the necessary liquidity to overcome current challenges. Insurers repeatedly assess businesses' recovery potential. However, without consistent, reliable, and useful dialogue, this assessment becomes difficult.

What to consider when renewing?

A specialist trade credit insurance broker can advise you on these considerations and give you their recommendation of the best offer for you.

These are areas to consider when you are considering renewal offers:

- The level of credit limits being offered on your customers
- The scope of the cover the policy offers you, for example:
    - does it cover you for what your business does?
    - do you require Work in Progress cover, cover for Binding Contracts, do you want a Notice Period before limits are withdrawn?
    - do you require Consignment Stock cover?
    - what payment terms are you allowed to offer?
    - can you comply with Discretionary Limit justification?
    - when do you need to report overdue debts, and submit claims?
- What is the policy structure, for example what is the Discretionary Limit level, the excess you retain in the event of a claim, Maximum Liability, what are the reporting requirements?
- What contact can you have with your insurer, either directly or via your broker?
- What systems does the insurer use?
- What is the premium and what value does the offer give your business?

What does good risk management look like?

Something that applies to all businesses regardless of sector is to always prepare for adverse trading conditions. Maintaining a strong balance sheet and a healthy liquidity buffer will help appease even the most risk averse third-party analyst.

With particular relevance to the construction sector there are a variety of different approaches taken with regards to risk appetite and even some accounting principles.

What insurers are looking for includes but is not limited to :

- Stable management teams with relevant experience
- A prudent approach to valuing work in progress
- Openness and honesty in dealing with the insurance market – the reluctance to do that can effectively be an act of self-harm
- Entering new markets or new areas of construction in a gradual and controlled manner
- Given the expectation of running into problems on contracts on occasion, insurers view the practice of routinely taking on contracts valued in excess of the net assets of the business as carrying inherent risk
- As per the above a prudent approach to dividends and advancing cash to related entities engaged in speculative development

Recent issues relating to cover in construction

The UK construction sector has seen a variety of issues across 2022 & 2023. The most common insurers have seen are :

Inflation

- The lack of flexibility offered by fixed price contracts in an environment with very high inflation in construction materials has seen numerous contractors reporting uncharacteristically poor performance.
- The higher interest rate environment introduced to address inflation can have an adverse impact on demand. Debt funded projects are commonplace and more expensive debt can make projects less attractive and in some cases unviable. This is most acute in in house building, residential and commercial projects.
- Housebuilders selling into the private residential market continue to experience subdued demand through the higher mortgage rate environment although this is starting to show some signs of recovery.
- With the resultant subdued demand as a result of inflation, tendering becomes more competitive which has the potential to affect future profit margins.

Building Safety Act

- This new legislation has seen a number of very large provisions being created and consequent losses as contractors prepare for the cost of cladding remediation works.

Supply Chain failures

- 2023 was an elevated year of insolvencies in the UK. Given the general environment highlighted above the construction sector was, as always, prevalent as a contributing factor.
- Insurers have heard numerous times how the impact of the failure of a subcontractor can cause significant

delay, disruption and cost to a project.

Delays

- Order books in the non- residential Construction sector have remained stable. However, delays in project start dates have been all too common. This is associated with a dampening in investor confidence, exacerbated by bond market fragility since the second half of 2022. Contract start date delays have caused 'phasing issues' for Contractors and subcontractors, affecting their cash flow management.
- Payment delays can be problematic at any point in the cycle. However, given the current high inflation environment, it is understandable that businesses in the sector are very focused on cash flow. A slowdown in payment behavior has compounded issues faced by the ‘End of Project Specialisms’ in particular.

Want more information?

If you want more advice and information about trade credit, head to the ABI website pages on trade credit insurance.

You can also contact your insurer directly, or speak to a specialist broker.