Extra Cover

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The Brazilian Market & Credit Insurance

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Surely most insurance brokers have been following recent financial market news about retail chain Lojas Americanas. Media publishes daily items on events, court proceedings and consequences of Americanas going into administration.

First off we need to explain what we mean by the Brazilian term, "judicial recovery" — the status that affects the retail chain.

What is "judicial recovery"?
It is a legal avenue pursued by companies who wish to avoid insolvency. The process lets companies suspend and renegotiate part of the debt they've accrued during a crisis, keeping the company from going out of business, laying off personnel and defaulting on payments.
Its main goal is to present a viable recovery plan demonstrating to creditors that the company can get back on track if it is able to renegotiate its debt. (1)

Most major suppliers to Lojas Americanas had purchased credit insurance to safeguard their business against financial loss arising from the company's bankruptcy filing. Unfortunately, the majority of the six thousand small and medium vendors on the creditor roster had not purchased credit insurance. Over the course of this article we will explore what credit insurance is, and how small to medium enterprises can benefit from it. Purchasing credit insurance in Europe is almost mandatory to European entrepreneurs. It is seen not as overhead but as an investment. Why investment and not overhead? Because credit insurance lets the insured grow their revenue selling more products and/or services to new markets (new customers) as well as increase their sales to existing customers without increasing credit exposure from those customers.

I'll take the liberty of quoting from a major newspaper(2) in the State of São Paulo on 13 February 2023.

"Americanas: almost R$1Bn in debt jeopardizes the operations of micro-, small and medium enterprises, stemming from suspension of payments in consequence of application for Judicial Recovery.
'It's like someone walked into my company premises, scooped up 35% of my cash flow and walked out the front door. That's kind of how I feel,' says the owner of a mid-sized school supply company who asked not to be named on this piece. Americanas owes the company a little over a third of its invoiced totals."

Credit Insurance

We should explain what credit insurance is to our brokers who don't know this kind of insurance and what kinds of services and benefits credit insurers have on offer.

Credit insurance covers the insured/creditor against financial loss caused by insolvency (judicial recovery and bankruptcy) and/or payment in arrears from the customer/debtor.

Not only does it cover the risk of the default but most insurers also include credit risk management services which consist of three very important pillars:

1. Credit Limits: Cap credit amounts individually for each debtor. One should establish a credit ceiling that is adequate to a company's size, financial health, and balance sheet. Their sales history and debtors' payments are also important factors to a general risk assessment.

2. Monitoring: Monitoring 24/7/365 is fundamental to put a stop to sales when delays in payment from the customer (debtor) are detected by the customer's other vendors

3. Judicial and Extra-judicial Collection Services: Debt collection services are included by insurers on their product portfolios. Instead of referring your debt collection to a debt collection agency, the insured can use their insurer to proceed with judicial and extrajudicial debt collection. Whatever is recovered during the collection period, pre-indemnity, through the insurer's diligence, is 100% returned to the insured. On a subsequent, post-indemnity phase, the insurer will typically reimburse the insured for 70% to 90% of the total invoiced amount.

The mitigation of credit risk and credit risk management services make of credit insurance as a product an indispensable tool to any company which intends to run a professional business, with good corporate governance.

Let's look into what happened to *Lojas Americanas*.

On 19 January 2023 the overseeing judge granted the company's application for judicial recovery. As a consequence, some six thousand vendors did not get paid for their shipments on consignment. The total outstanding amount has been estimated at R$20Bn owed to thousands of suppliers of products and services.

Suppliers who had bought credit insurance are now collecting required documents so that they will be indemnified over the next few days. Suppliers who have no credit insurance will have to wait on the judge's decision based on a debtor-creditor agreement which will determine the amount of debt write-down and define a payment deadline. Write-down and deadline have not yet been negotiated by the parties. However, based on the prior outcomes of other judicial recoveries, we can expect debt write-downs from 30% to 90% and payment windows between 15 to 20 years.

In comparison, vendors who have credit insurance will get 90% of their loss reimbursed by their insurers (typically the insured has a 10% deductible) within up to 30 days from the date the creditor roster is published. This clearly and evidently illustrates the advantages of credit insurance when a customer/debtor applies for judicial recovery or files for bankruptcy.

At this point we should highlight that insurers, once they have compensated the insured, enjoy the prerogative of recouping their losses, although limited to write-downs and time frames approved by the debtor-creditor agreement mentioned above.

It is hard to say how many small and medium enterprises will survive the Lojas Americanas default. Those who do make it to the other side should buy credit insurance as soon as possible, so as not to make the same mistake twice. Insurance brokers have a professional duty which includes at least making credit insurance available to their customers.

Credit insurance can be purchased by most companies selling products and services in Brazil. The economic sectors now leading purchases of credit insurance are:

- Agribusiness (seeds, fertilizers, agrochemicals)
- Food and drink
- Capital goods
- Pharmaceutical
- Transformative industry (plastics, metallurgy, others)
- Financial Institutions
- Steelmaking
- Service Industry
- Textiles
- Information and Computing Technologies
- Retail

Currently, we have 7 credit insurers operating in the Brazilian market. They are:

- AIG
- Allianz Trade
- Avla Seguradora
- CESCE
- Chubb
- Coface
- Crédito y Caución — Atradius Group.

In conclusion, I would like to stress that insurance brokers must advise the insured that credit insurance is a worthwhile investment if they wish to guarantee the survival of their companies when their best customers file for bankruptcy. It also lets them grow sales securely by finding new markets or increasing their business with pre-existing clients without increasing their credit risk.

Over the next months SINCOR SP will schedule talks on credit insurance aimed at unionized brokers. More news soon!

By Phillip Krinker, Insurance broker, BA in Management, Director at CredRisk-MDS Group, permanent member of the Credit Committee/Guarantees/Securities at SINCOR, and writer.

Sources

(1) Sebrae
(2) O Estado de São Paulo (Estadão)