The best policy

There has been much discussion and press coverage of the reduction in credit insurance capacity in the UK and other markets. This has caused a number of companies to consider reappraising their approach to credit insurance. Solutions can involve doing the same thing better, or doing things in a different way.

Much of the rethinking questions the value of ground-up insurance structures (where the vast majority of the sales ledger is insured). Does it make financial sense to insure the predictable? Many companies now recognise the need for more risk retention. Some are also considering setting up their own captive insurer (captives finance risks emanating from their parent group) or a protected cell captive (protected cells offer a company part-ownership of a captive but full ownership of the part – the cell – that deals with its own insurance business). This overall approach has a long-term view which is important to treasury: to protect debtor assets against unexpected or catastrophic events.

But consideration of credit insurance arrangements is not the start of the process: it is the conclusion. First and foremost, companies must have rigorous and systematic credit management risk standards and procedures in place. Many companies recognise this. They want high standards and they want control not just for the front-end (a proactive approach) but also from a compliance point of view. The biggest risk for any captive solution is that a "catastrophe" claim is rejected because of non-compliance with the insurer's requirements.

But achieving high standards is easier said than done. Perhaps the two biggest challenges to overcome are:

- the perception of credit management as a back-office function that gets limited board attention or interface with sales; and
- the restraints imposed by limited credit management functionality in accounting systems – a restraint exaggerated when different systems are used throughout the business.

The solutions lie in recognition, people and technology:

- **Recognition** The board must recognise that credit management is the oil in the engine – vital in harmonising sales and risk strategies.
- **People** High-quality credit managers who can step up to the plate need to be recruited – people with technical, management and relationship-building skills – and adequately empowered.
- **Technology** The latest web-based credit management tools can manage processes and ensure compliance across diverse accounting systems. Web-based systems deliver rich functionality and can help users enhance performance and reduce costs far more quickly and cheaply than an in-house systems implementation.

Executive summary

- **Effective credit management protects the balance sheet, and, when harmonised with sales, can help improve performance and lower acquisition costs.**

Effective credit management can do much more than protect the corporate balance sheet. When harmonised with sales it can help improve performance and lower acquisition costs. Professional credit managers see credit management as of fundamental importance, and take time to build the right relationships and understanding. Good credit management can also help improve customer service; the credit team usually know where the problems and bottlenecks lie within the organisation.

Some excellent credit management software tools are now available and two distinct routes can be followed. The first is software as a service (SaaS), in which credit limit setting, monitoring and reporting can be automated to your own rule sets. SaaS gives highly graphical management reporting covering, among other things, risk aggregation, risk mapping, payment performance, overdue reporting and cash forecasting. It also allows management to override decisions while keeping full audit trails. The SaaS approach is fundamentally concerned with efficiently managing processes and empowers financial management.

The second route delivers much of the SaaS functionality but also provides more of a value-add by offering external advice and support where needed. As companies move away from credit insurance they will lose the underwriter's assessment of their credit risks – an assessment that many companies value. In this approach the web-

WHATEVER CREDIT INSURANCE ROUTE YOU TAKE, THE CORNERSTONES OF HIGH-QUALITY CREDIT MANAGEMENT ARE CORPORATE RECOGNITION OF ITS IMPORTANCE, PLUS THE RIGHT PEOPLE AND THE RIGHT TECHNOLOGY, AS **SIMON MARSHALL** EXPLAINS.

delivered functionality is supported by the availability of underwriter-quality risk recommendations from analysts who are themselves highly experienced former credit insurance underwriters. This is a relationship model in which you can talk to and share information with your senior risk analyst, which holds considerable appeal to professional credit managers. The big credit risk decisions are rarely black and white.

You may wish to keep traditional credit insurance in place for your organisation, but there is always a better way of doing things. The above principles make considerable sense because they enable performance improvement at reasonable cost, and provide strategic flexibility for future insurance planning.

More importantly, this approach delivers a high level of transparency for the receivables asset and its management. Unlike paper-based systems, controls are embedded and visible. The ability to demonstrate this – and to be able to view or report on group-wide or individual risk positions as at "close of play last night" – is not only attractive to treasurers, it is also attractive to lenders and puts you in a stronger position when negotiating receivables finance.

The current climate may have raised awareness of credit insurance, but the issue is not simply one of renewing or reviewing the insurance. An efficient credit management approach has to be both proactive and all-encompassing. You need to decide the company's credit risk management strategy, choose the partners you want to work with, deploy the tools, and then go out and make your insurance and your finance complement these arrangements. This will ultimately represent a better arrangement for you, and for your insurer or lender.

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Still better than deposits…

MARK ASHLEY EVALUATES THE BENEFITS OF USING MONEY MARKET FUNDS.

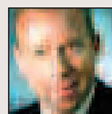
The financial crisis combined with the substantial tightening of credit conditions has brought money market funds (MMFs) into sharp focus as investors try to find short-term secure homes for their cash reserves. MMFs are now well recognised as an attractive alternative to short-term bank deposits but the mechanics of how they are structured to deliver this promise has come under increasing scrutiny. The regulations and controls for MMFs are undeniably stringent but they do leave scope for flexibility within their investment universe. The underlying differences between the investment strategies of broadly similar funds have been highlighted by the issues in the financial markets.

When treasurers are looking for suitable alternative strategies they should not sacrifice any of the benefits of short-term bank deposits, such as liquidity or capital preservation. To do this, they must fully understand the investment philosophy of the MMF and focus on the conservatively managed CNAV funds that invest in a high proportion of extremely high-quality liquid assets.

Funds that satisfy these criteria give the following benefits:

- **A reduction in counterparty risk**: MMFs are AAA-rated mutual funds through investment in a diverse range of high-quality short-term securities. A bank deposit by its nature is a single exposure to a financial institution with, typically, a lower credit rating than AAA. Investors are therefore able to capture significant diversification and security through the investment in a larger MMF.
- **Liquidity**: MMFs are able to provide liquidity by utilising the "liquidity ladder" through diversified investing, with investments that span a time period to take advantage of term premium but also to maintain liquidity. The Insight Liquidity Fund for example is stress-tested on a one-day, one-week and one-month basis to make sure we always have sufficient liquidity to meet the harshest redemption profile.
- **Greater consistent returns**: The conservatively managed CNAV Insight Liquidity Fund illustrates the favourable returns compared to short-term bank deposits, giving an equivalent return closer to the three-month LIBOR rate, while still providing instant access.

MMFs are an excellent alternative to short-term deposits and should certainly be considered as a useful tool for any treasurer trying to optimise the benefits of cash management.



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