Feast after the famine

AFTER A TURBULENT PERIOD FOUR YEARS AGO, TRADE CREDIT INSURANCE IS READILY AVAILABLE AGAIN DESPITE THE DEEPENING EURO ZONE CRISIS. **GRAHAM BUCK** REPORTS.

As expectations rise that many euro zone economies are facing a further period of recession this year, so interest in trade credit insurance has been growing.

Broking group Marsh recently hosted a briefing at which it reported a sharp rise in inquiries about the product from companies based in Asia and North America during the second half of 2011. Awareness is also building in the Middle East region, Eastern Europe and the CIS countries. Insurers are more wary of providing trade credit insurance cover in the latter regions due to a relative lack of transparency about companies' financial health, although relatively few losses have been experienced so far.

Meanwhile, the market for trade credit insurance has regained much of its buoyancy in the past couple of years. This is despite Europe's poor growth prospects, mounting concerns over the "PIIGS" economies of Portugal, Ireland, Italy, Greece and Spain, and the likelihood of further problems related to sovereign debt.

Trade credit insurance remains a relatively restricted market compared with most other forms of business insurance. There are around 15 active players and the "Big Three" of Atradius, Coface and Euler Hermes continue to dominate. However, competition has been stepped up by others such as Chartis, QBE, Zurich and several Lloyd's of London syndicates. Since 2010 these names have been joined by two new entrants, Markel International and Equinox Global, although both currently focus on excess of loss cover for larger exporters rather than the "ground-up" cover required by SMEs.

The extra capacity has meant that, in addition to premium reductions, the percentage of self-insurance required from exporters is being lowered again after increases were imposed in 2008. In many cases 95% cover is available for traditional ground-up policies and 100% for excess of loss. Deductibles have also been reduced and other restrictions eased, in response to an improvement in claims experience during 2010 and 2011. Non-cancellable limits are now offered by a number of insurers.

While greater competition has resulted in softer market conditions, Martin Holland, managing director of the credit and surety division at broker Gallagher Heath, reports that they have not yet returned to the levels prevailing back in 2007. "Insurers had probably gone too far at that time, with a prolonged period of benign economic conditions encouraging them to take their eye off the ball," he says. "They were offering companies high limits of cover without first requesting up-to-date financial information from them."

As the downturn hit, underwriters stepped up their requests for this information and companies became more willing to accede. As a

result, cover is now readily available for well-run businesses even in hard-pressed sectors such as retail.

This is in contrast to the months immediately following the demise of Lehman Brothers in September 2008. Capacity shrank, with many companies being offered sharply reduced policy limits or even losing their cover entirely. Having traditionally been a relatively small and largely overlooked segment of the overall industry, trade credit insurance attracted fierce criticism that it was being withdrawn just when needed most.

The prevailing sense of panic, coupled with relatively lax underwriting standards that meant insurers lacked up-to-date financials on their corporate clients, led to cover being cancelled across the board for those companies with lower credit ratings. Tim Smith, Marsh's trade credit practice leader for Europe, the Middle East and Africa, says that at the time insurers made very broad decisions over cover, often resulting in a significant shortage for entire industry sectors.

Underwriting has since become more sophisticated. Companies are reviewed on an individual basis and underwriters maintain a regular dialogue with clients. "Insurers naturally favour those companies that can demonstrate comprehensive credit management procedures, which aren't necessarily always the biggest," Smith adds. "Their trade credit insurance portfolios include products for mid-market companies and large multinationals, each of which is reviewed slightly differently but with a focus on the due diligence and credit management procedures."

Not surprisingly the sovereign risk and political risk of the country in which the company operates is a major consideration, although insurers can and do compete for the "better quality" corporates, even among the PIIGS.

Multinational companies are increasingly seeking trade credit insurance cover to protect themselves against catastrophic events and resulting defaults, as well as protection for their balance sheets. Smith expects more companies to use captive insurers to provide cover and an increase in strategies such as using trade credit insurance for funding purposes.

Premium rates reduced during the first half of last year before stabilising in the second half as the euro zone crisis intensified, he says. However, they are still some way above the levels of five years ago following sharp increases in 2008 and 2009. For this year he expects them to be "stable", or in a range between zero and 5% higher, with individual increases reflecting the company's structure, loss ratio and its industry sector.

FRAIL RETAIL Marsh reports that the weakness of the retail sector is causing particular concern, with even Europe's stronger economies such as Germany and Poland experiencing retail insolvencies and a similar story in North America. Other vulnerable sectors include pulp and paper production, which is suffering from overcapacity and low prices. The solar power industry is another, with payments delays resulting from many governments either reducing subsidies or withdrawing them completely. Rising commodity prices have added further to the problems of companies pioneering solar energy.

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Smith says insurers report that more companies are delaying payments as they attempt to reschedule their debt load, and the number of "seriously overdue" accounts, where payments are between 60 and 90 days late, has risen steadily in recent months to stand around 50% higher than 12–18 months ago in the UK, France, Italy and Spain. "Insurers see the majority of their predictable losses coming from overdues, so they now request from the company either a monthly or quarterly report of all overdue accounts," he adds.

Despite this increase, and Europe's weak economic outlook, expectations for the likely increase in insured losses during 2012 are fairly modest. A rise of 2–5% is anticipated in line with a greater number of company insolvencies. This prediction is based on the premise that Greece, possibly followed by Portugal, is likely to exit the euro zone and a "two-speed" Europe ensue. Insurers believe that a more serious break-up will be averted, and the odds on a more widespread global recession are also still considered low.

While the market for trade credit insurance has broadened with the recent addition of the new players, Smith doubts whether many more will follow. "There are quite high barriers to deter new entrants, particularly in setting up operations to assess the creditworthiness of customers." Meanwhile, existing participants are extending their product range by introducing options such as non-cancellable and top-up covers.

PLUGGING THE GAP Many government-backed schemes hastily introduced to plug the gap are regarded as having served their purpose and have been withdrawn, with a few exceptions such as Portugal. The UK government's own top-up scheme introduced in 2009 was regarded as fairly disastrous and "too little, too late", although Holland adds that it has been mothballed rather than killed and could be revived at a later date if needed.

More recently the state-backed Export Credit Guarantee Department (ECGD) reacted to criticisms that it neglects the needs of smaller exporters by launching a number of initiatives in 2011 aimed at SMEs. Among them was a trade credit insurance product for those seeking to export beyond the traditional markets of the EU and OECD. Take-up to date has been fairly low, but this could change once rates applied by the commercial insurance market start to rise.

"Anecdotally it appears that in January this year – when most credit insurers renew their reinsurance treaties – underwriters reported companies experiencing more overdue debts and/or customers requesting rescheduling of debts than a year earlier," says Holland. "So rate reductions are now likely to ease off and you may see increases beginning at the start of 2013.

"While insurers are looking closely at Greece and the southern Europe economies of Italy, Portugal and Spain, there hasn't been any mass withdrawal of cover for any of these countries. They are also still generally willing to provide cover for Ireland, provided up-to-date financials are available. Each of the Big Three has offices there, so it's highly unlikely they would pull out."

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