Commentary

COVID 19: European Governments Have Moved Swiftly To Protect Availability Of Trade Credit Insurance

DBRS Morningstar
11 June 2020

Victor Adesanya
Vice President
Global Financial Institutions Group
+1 416 597-7350
victor.adesanya@dbrsmorningstar.com

Marcos Alvarez
Senior Vice President, Head of Insurance
Global Financial Institutions Group.
+1 416 597-7553
marcos.alvarez@dbrsmorningstar.com

Key Highlights:

- European countries have taken steps to protect business activity in their jurisdictions by initiating government-backed schemes targeted at protecting business-to-business trade by ensuring the continued availability of trade credit insurance.
- Businesses need trade credit insurance because the extension of trade credit exposes the provider to default risk. This is the risk of default on the debt as a result of the borrower failing to make required payments within the period allowed by the trade credit agreement.
- The private trade credit insurance market is dominated by three insurance groups (which collectively account for over 80% of the global credit insurance market as of 2018).

Overview

The economic impact of the Coronavirus Disease (COVID-19) continues to be felt across the globe, including the severe disruption of global supply chains. Various countries in Europe have taken steps to protect business activity in their jurisdictions by initiating trade credit insurance guarantee schemes targeted at protecting business to business trade. The government of the United Kingdom also followed this trend by announcing on June 4, 2020, that businesses with supply chains that depend on trade credit insurance and businesses experiencing difficulties maintaining trade credit insurance cover due to the pandemic will be supported by a temporary (nine months) government scheme up to GBP 10 billion.

We anticipate that the actions taken by various governments will ensure the continued availability of trade credit insurance, while providing support for business-to-business transactions by mitigating the risk of credit default on goods and services. Businesses will have the confidence to continue trading knowing that they are protected, which is particularly important for small and medium size enterprises.

What Is Trade Credit, And Why Is It Important For Businesses?

Trade credit is an agreement between businesses where a company permits its customers the purchase of goods and services on credit without having to make payment immediately. Payment is usually made within 30 days to 90 days after the purchase. This is an important external source of short-time financing also referred to as working capital financing. Since payment is not immediately made, the deferred payment represents a source of short-term finance.

Trade credit allows companies to receive goods or services that can then be resold (as in the case of retail stores or raw materials needed for manufactured goods) with the net proceeds used to pay back the short-term debt owed to the supplier. Without trade credit, many small business and new businesses would struggle to raise enough working capital to operate.

What Is Trade Credit Insurance?

Trade credit insurance is an insurance product offered by private insurance companies and governmental export credit agencies to business entities. The insurance policy issued provides protection to traders, service companies, and manufacturers against potential losses from default or nonpayment of a commercial trade debt. The insurance policy provides cover for companies that want to mitigate the risk of credit default on their receivables. In Europe it is offered mostly by private insurance companies that operate in this sector or government-supported insurance companies. In North America (and other parts of the world), it is mostly offered through government entities that are not operating as insurance companies (such as Export Development Canada). Some trade credit insurance products may include protection for political risk. The political risk insurance cover protects against credit default by foreign buyers due to political unrest or actions taken by foreign jurisdictions that elevates the risk of default by the foreign buyer. If a buyer is a unable to pay because of bankruptcy, insolvency, or delays in its payments, the trade credit insurance policy will pay out a percentage of the outstanding debt.

Why Do Businesses Need Trade Credit Insurance?

The extension of trade credit exposes the provider of credit to credit default risk. This is the risk of default on the debt as a result of the borrower failing to make required payments within the period allowed by the trade credit agreement. This could lead to insolvency for the supplier, because it might not have enough resources to replenish its stock or continue operations if a large section of its customers were to default on their trade credit payments. It also has the potential to impact some industry sectors more harshly because of linkages in the supply chain of many companies that depend on each other for components, or parts required to produce a finished product. For example, in the automobile industry there are several external automobile parts suppliers to a single car assembly line.

In many cases the dependencies extend beyond country borders. As business activity across the world becomes more globalized, companies trading cross border and within a jurisdiction are driving up the demand for trade credit insurance. It was reported that the global credit insurance market was estimated to be about USD 8.64 billion in 2017 and is anticipated to grow at a compound annual growth rate of 2.9% to USD 10.77 billion by 2025.[1]

Which Companies Are The Main Providers Of Trade Credit Insurance Globally?

The private trade credit insurance market is dominated by three insurance groups that collectively account for over 80% of the global credit insurance market as of 2018.[2] These organizations have expanded their operations to cover Western Europe and Eastern Europe, and have also moved into the American and Asian markets. The companies are listed as follows:

- **Euler Hermes:** This is the largest provider of trade credit insurance globally. It offers a wide range of guarantees, bonding, and collections services used to manage business-to-business trade receivables. Euler Hermes employs close to 6,000 employees and operates in over 50 countries. It is a subsidiary of Allianz SE, a German multinational financial services company headquartered in Munich, Germany.
- **Atradius:** This company provides trade credit insurance, surety, and credit collection services globally, with operations in more than 54 countries. It is the credit insurance division of Grupo Catalana Occidente, a leading Spanish insurance organization with a global presence.
- **Compagnie Française d'Assurance pour le Commerce Extérieur (Coface)**: Coface distributes credit insurance products directly or through strategic partnerships in about 100 countries. As a result of its vast network, it has the capacity to provide insurance cover to clients in approximately 200 countries. Its

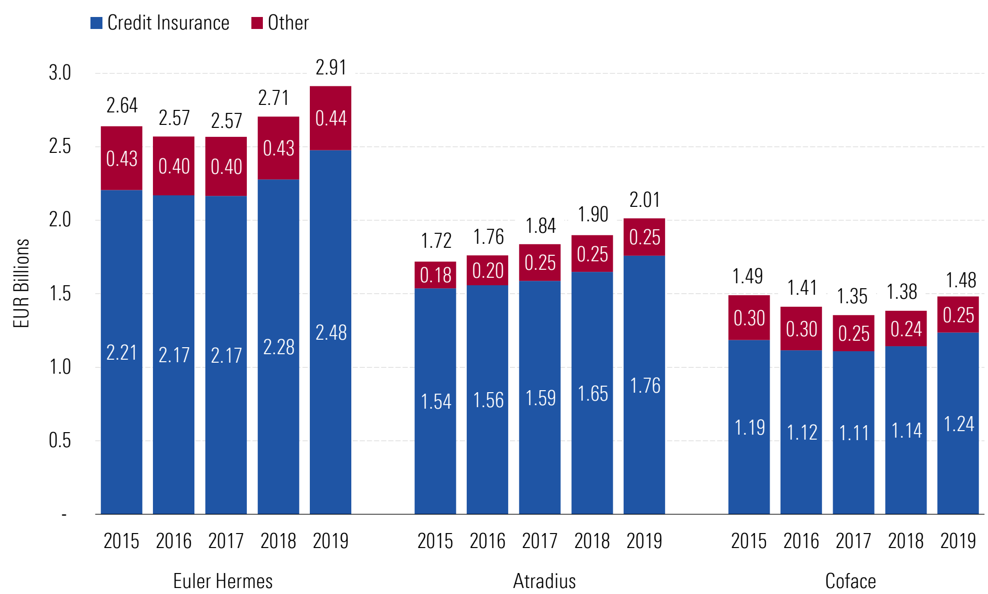
1 Credit Insurance Market to 2025 - Global Analysis and Forecasts by Component (Products, and Services); Enterprise Size (Small & Medium Enterprise, and Large Enterprise); & Application (Domestic, and Export), The Insight Partners, October 2018.

2 The Credit Insurance Market in 2018, AU Group.

main product is credit insurance; however, other services provided include debt factoring services, proprietary business information, and a receivables collection service.

Exhibit 1 shows the 2015 to 2019 premium distribution for each of companies described above.

Exhibit 1 Premium Distribution 2015 to 2019 for the Leading Trade Credit Insurers



Source: DBRS Morningstar, Company Annual Reports.

What Are The Actions Taken By Various Governments To Protect Trade Credit in Europe?

- **Belgium:** On April 21, 2020, it was reported that a memorandum of understanding was signed between the Belgian State, Credendo Insurance Company, Assuralia (Professional Association of Insurance Companies in Belgium), and private credit insurers. The purpose of the agreement is to provide support for the Belgian economy by maintaining credit limits that are provided by private credit insurers to companies operating in Belgium. The agreement results in the establishment of a reinsurance program that allows private credit insurers to continue to provide cover despite the continuing impact of the coronavirus pandemic. Credendo Insurance Company will provide reinsurance cover on behalf of the State.[3]
- **Denmark:** The European Commission gave its approval on May 15, 2020, for a guarantee scheme established by the government of Denmark with the intention of stabilizing the Danish trade credit insurance market. The program is valued at DKK 30 billion, and results in local insurers providing a commitment to maintain current levels of protection in exchange for the state's guarantee. This arrangement will provide cover for trade credit business until the end of 2020. The sovereign guarantee ensures that trade credit insurers in Denmark are able to maintain their normal insurance capacity

3 Credit Insurance: Reinsurance Programme by the State to Support the Belgian Economy, Credendo, April 22, 2020.

during the coronavirus pandemic and until the end of 2020. This arrangement is available to organizations that offer short-term credit with a limit of up to 180 days.[4]

- **France:** The government increased the maximum limit of public reinsurance for short-term export credit insurance to EUR 5 billion from EUR 2 billion, on March 23, 2020.[5] This was to provide protection for companies against the risk of payment default. The government also provided a maximum guarantee of EUR 10 billion to the Central Reinsurance Fund. The fund is authorized to engage in insurance or reinsurance arrangements initiated before December 31, 2020, for credit insurance risks involving small and medium size enterprises and midsized enterprises operating in France. In addition, France extended the scope of the public reinsurance scheme and increased the maximum limit for public reinsurance of short-term export credit insurance operations to EUR 2 billion from EUR 1 billion.
- **Germany:** On April 14, 2020, the European Commission announced the approval of the German guarantee scheme to support the trade credit insurance market because of the outbreak of the coronavirus disease. The scheme ensures the continued availability of trade credit insurance to all companies operating in Germany, thus preventing the need for purchasers of goods or services having to pay in advance.[6]
- **Netherlands:** On May 25, 2020, the European Commission announced the approval of a guarantee scheme initiated by Netherlands to support the trade credit insurance market. This scheme guarantees the continued availability of trade credit insurance for all companies operating in the Netherlands and reduces pressure on their immediate liquidity needs.[7]
- **United Kingdom:** On June 4, 2020, the government announced the initiation of a GBP 10 billion scheme to temporarily guarantee business-to-business transactions that are supported by trade credit insurance. The scheme will be backdated to April 1, 2020, and will continue until December 31, 2020. This ensures that existing trade credit insurance coverage will continue to be maintained.[8]

---

4 Coverage in the Danish trade credit insurance market restabilised, EKF.

5 Tracker of EU and UK Financial Sector Regulatory Initiatives in response to COVID-19, Cleary Gottlieb, June 2, 2020.

6 COVID-19: Commission approves German guarantee scheme to stabilise trade credit insurance market during coronavirus outbreak, Practical Law, Thomson Reuters, April 14, 2020.

7 COVID-19 tracker: EC approves Dutch guarantee scheme to stabilise trade credit insurance market, Lexology, May 25, 2020.

8 Trade Credit Insurance backed by £10 billion guarantee, HM Treasury, Department for Business, Energy & Industrial Strategy, John Glen MP, and The Rt Hon Alok Sharma MP, June 4, 2020.

About DBRS Morningstar

DBRS Morningstar is a global credit ratings business with approximately 700 employees in eight offices globally.

On July 2, 2019, Morningstar, Inc. completed its acquisition of DBRS. Combining DBRS' strong market presence in Canada, Europe, and the U.S. with Morningstar Credit Ratings' U.S. footprint has expanded global asset class coverage and provided investors with an enhanced platform featuring thought leadership, analysis, and research. DBRS and Morningstar Credit Ratings are committed to empowering investor success, serving the market through leading-edge technology and raising the bar for the industry.

Together as DBRS Morningstar, we are the world's fourth largest credit ratings agency and a market leader in Canada, the U.S., and Europe in multiple asset classes. We rate more than 2,600 issuers and 54,000 securities worldwide and are driven to bring more clarity, diversity, and responsiveness to the ratings process. Our approach and size provide the agility to respond to customers' needs, while being large enough to provide the necessary expertise and resources.

MORNINGSTAR | DBRS

The DBRS group of companies consists of DBRS, Inc. (Delaware, U.S.)(NRSRO, DRO affiliate); DBRS Limited (Ontario, Canada)(DRO, NRSRO affiliate); DBRS Ratings GmbH (Frankfurt, Germany)(CRA, NRSRO affiliate, DRO affiliate); and DBRS Ratings Limited (England and Wales)(CRA, NRSRO affiliate, DRO affiliate). Morningstar Credit Ratings, LLC is a NRSRO affiliate of DBRS, Inc.

For more information on regulatory registrations, recognitions and approvals of the DBRS group of companies and Morningstar Credit Ratings, LLC, please see: http://www.dbrs.com/research/highlights.pdf.

The DBRS group and Morningstar Credit Ratings, LLC are wholly-owned subsidiaries of Morningstar, Inc.