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Commentary

Trade Credit Insurers Face Prospect of Elevated Russian Claims as War in Ukraine Persists

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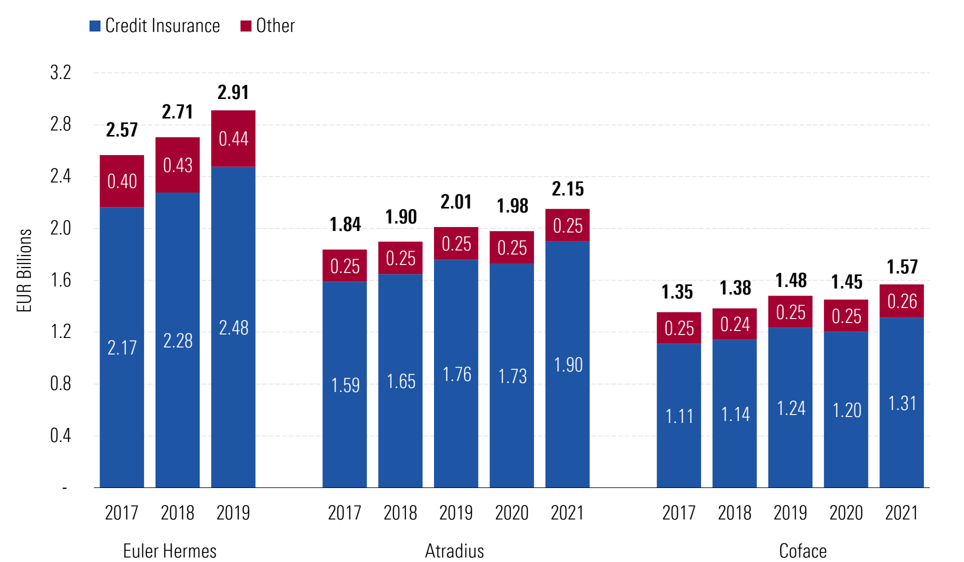
Key Highlights

- There is an elevated risk of credit defaults for exporters that have supplied goods on credit to Russian companies.
- Similar to other insurance policies, trade credit insurance coverage usually comes with war exclusions, which will result in limited exposure for insurers that provide coverage for exports to Ukraine.
- 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 that collectively account for more than 85% of the global credit insurance market.

Following the invasion of Ukraine, Russia's economy has been pummeled by a barrage of economic sanctions, and an increasing number of European and North American companies are either exiting or limiting business exposure to the country. This has elevated the risk of credit defaults for companies that have supplied goods on credit to Russian companies. As a result, trade credit insurers[1] should expect to deal with an inflow of credit default claims by insured entities once their business counterparts in Russia and Ukraine start missing payments for the goods or services rendered to them on short-term credit. War exclusions may limit trade credit insurers' loss exposures to business related to Ukraine but will likely not apply to business in Russia since the conflict is not within Russia's borders. Russian companies may fail to transfer funds to foreign suppliers as a result of economic sanctions imposed on them. Trade credit insurers have already started pulling back from offering insurance coverage to organizations that export to Russia and Ukraine, responding to imposed sanctions and the elevated risk of claims caused by payment default.

Exhibit 1 shows the premium distribution for 2017 to 2021 for each of the largest trade credit insurers.

Exhibit 1 2017 to 2021 Premium Distribution for the Leading Trade Credit Insurers



Note: 2019 is the most recent data available for Euler Hermes.
Source: DBRS Morningstar, company documents.

1 See appendix for a detailed explanation of trade credit and trade credit insurance.

Sanctions Elevate Risk of Credit Default

The barrage of financial sanctions on Russia has elevated the risk of payment defaults, which could be borne by insurers and reinsurers alike. We expect many insurers and reinsurers to exit Russia in the coming months, with some already moving to reduce exposure, which will add more pressure to the already-struggling Russian economy. Trade credit insurance protects against nonpayment by debtors like Russian companies that purchase goods from foreign suppliers or receive financing from foreign banks. We anticipate that these providers, and others in the industry, will continue to significantly limit their exposure to Russia going forward; however, they are still exposed to business initiated before the conflict started. Foreign goods and services suppliers are also likely to pull back from doing business in Russia if they are unable to purchase credit insurance. Sanctions on Russian banks, such as their exclusion from the Society for Worldwide Interbank Financial Telecommunications (SWIFT), elevate the risk of default if companies cannot execute international financial transactions.

Trade Credit Insurance Providers Likely to Limit Exposure to Russia

On March 14, 2022, German insurer Allianz (parent company of Euler Hermes, the world's largest private trade credit insurer) announced that it had stopped writing new business in Russia. Following this, on March 17, 2022, it was reported that Belgium’s export credit agency Credendo, which also provides private credit insurance, was assessing the future of its joint venture with a Russian commercial insurer. On March 24, 2022, Lloyd’s of London (Lloyd’s) reported that the Russian invasion of Ukraine will have short-, medium-, and long-term impacts on its performance and balance sheet. Direct premiums written generated from Russia and Ukraine make up less than 1% of Lloyd's total premium; however, Lloyd’s has indirect underwriting exposure to various insurance products, including trade credit insurance related to both countries.

The private trade credit insurance market is dominated by three insurance groups that collectively account for more than 85% of the global credit insurance market; these organizations have expanded their operations to cover Western Europe and Eastern Europe and have also moved into the North American and Asian markets. These companies may have to pay out significant claims in the coming months as the conflict persists:

- Euler Hermes: 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 more than 50 countries. It is a subsidiary of Allianz SE, a German multinational financial services company headquartered in Munich.
- Atradius: Provides trade credit insurance, surety, and credit collection services globally, with operations in more than 50 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): 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 main product is credit insurance; however, other services provided include debt-factoring services, proprietary business information, and a receivables collection service.

War Exclusions May Limit Trade Credit Insurers' Exposure to Ukraine, but Not Russia

Similar to other insurance policies, trade credit insurance coverage is usually subject to war exclusions, which could result in limited exposure for insurers that provide coverage for exports to Ukraine. Under the typical war exclusion clause for trade credit insurance, coverage would exclude claims due to war; invasion of, or acts by, foreign enemies; rebellion, hostilities, revolution, nationalization, confiscation, insurrection, military coup d'état, or usurped power; and actions due to the order of a government within its jurisdiction. However, most exclusions may not apply to Russia because the war is not taking place within its borders. There is an elevated risk of credit default for organizations that have supplied goods or provided services on credit to Russian companies. Therefore, trade credit insurers with existing exposure to Russia should expect an inflow of claims in the near term if suppliers and service providers do not get paid for goods already supplied or services provided.

Related Research

- *Prolonged Economic Sanctions – A Risky Scenario for European Insurers*, March 17, 2022.
- *Cyber Warfare Following Russia's Invasion of Ukraine Likely To Drive Up Claims for European and North American Insurers and Reinsurers*, March 9, 2022.
- *War, Weather, and Coronavirus Create Headwinds for Reinsurers Following Strong 2021 Results*, March 4, 2022.
- *Cost of December Tornado Outbreak Expected to Be Within Historical Range and Manageable for U.S. P&C Insurers*, December 15, 2021.
- *IFRS 17: A Significant Change for the Global Insurance Industry*, November 29, 2021.
- *The Global Supply Chain Crisis Exposes the Limits of Business Interruption Insurance*, November 2, 2021.
- *Global Reinsurers Post Record Earnings in H1 2021 but Face Headwinds from Catastrophe Losses and Coronavirus Litigation*, September 29, 2021.
- *The Suez Canal Blockage Is Likely to Have a Limited Impact on the Global Insurance Industry*, March 30, 2021.

Appendix

What Is Trade Credit and Why Is It Important for Businesses?

Trade credit is an agreement between businesses whereby one company (i.e., the supplier) permits another company to purchase goods and services on credit without having to make payment immediately. Instead, payment is usually required within 30 to 120 days following the purchase/delivery of goods or services. The deferred payment represents a source of short-term finance. With trade credit, companies 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 and Why Do Businesses Need It?

Trade credit insurance is an insurance product that provides protection to suppliers (traders, service companies, and manufacturers) against potential losses from default or nonpayment of a commercial trade debt. Trade credit insurance is offered by private insurance companies and governmental export credit agencies to business entities 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 the sector or by 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 caused by political unrest or actions taken by foreign jurisdictions that elevate the risk of default by the foreign buyer. If a buyer is 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 depending on the terms of the policy.

Businesses need trade credit insurance because the extension of trade credit exposes the credit provider (i.e., the supplier) to credit default risk, which 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 payments. It also has the potential to affect some industry sectors more severely because of supply chain linkages between 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.

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