EMERGING RISKS

Credit losses mount

With Central and Eastern Europe mired in economic crisis, insurers face total industry loss exposures of $2.5bn

Trade credit insurance is drawing wider attention as a bellwether for the global economy – and for underwriters exposed to this line the third quarter has stacked up mounting losses.

Chaucer and Beazley are among Lloyd's insurers to have revealed political risk/trade credit losses over the quarter, while estimates by our sister title *The Insurance Insider* put the total industry loss exposure to the 2008-09 world economic downturn at $2.5bn.

BPL Global chief executive Charles Berry, speaking at Lloyd's early in November, said that he anticipated losses net of recoveries of $1-$1.5bn (excluding related terrorism and political violence business).

These are not huge losses for the industry as a whole to shoulder, but for the individual participants the hits remain substantial and reflect the deepening financial chaos that spread into emerging markets this year.

As *The Insurance Insider* reported in November, regions such as the former Soviet Union and Central and Eastern Europe have become prone to trade credit defaults this year, with their commodity-reliant economies and recently privatised banking sectors.

Chaucer was one of the Lloyd's insurers to indicate that its trade credit business struggled in Q3, with the economic downturn triggering payment defaults in developing countries, including Bahrain, Kazakhstan and Ukraine.

The company has had to make further provisions of £23.5mn for potential Q3 losses in the political risk account of its marine division.

At the beginning of November another participant in the trade credit market, Beazley, revealed it would provide for £33m losses from its political risk and contingency book identified in the third quarter.

Beazley's provision follows a sharp increase in claims notifications in recent months, with losses stemming from Ukraine and Kazakhstan, as well as Brazil.

The Lloyd's insurer previously said in its half-year report that it had adjusted reserves for ultimate losses for the 2007 and 2008 years of account, with claims up for the underwriting years 2006-2008.

Collins Stewart insurance analyst Ben Cohen noted: "The loss assumes claims frequency will remain high into 2010, and a limited rate of recovery of future claims."

However, reserve releases were expected to offset the impact on its bottom line. They came primarily in specialty – driven by maturing claims trends on the 2003-2006 underwriting years – as well as for marine and reinsurance.

Reflecting the gathering uneasiness among investors over political risk/ trade credit exposures, Collins Stewart downgraded the Lloyd's insurer to hold and in its research note called for "additional disclosure on the reserve setting process in political risks, including assumptions of loss severity and frequency by geography and industry".

The political risk insurance market is an umbrella term used to include nationalisation and expropriation, together with government obligor defaults and structured trade credit, as well as terrorism and political violence and short-term multi-buyer credit insurance.

According to BPL Global, premium income generated by political risk business amounted to $1.2bn in 2008. Structured credit-style cover accounted for around half of this, with pure political risk generating premiums of approximately $200mn and government defaults $400mn.

Berry said that structured credit capacity was likely to undergo "severe contraction" in 2010, although cover would become more costly, with the government obligor default-linked business declining slightly as premium rates rise.

Ukraine crisis serves up $500mn losses

Ukraine is just one example of an emerging economy rocked to its foundation by the financial crisis that poses further risk for trade credit insurers.

Fitch gave the nation a negative B- credit rating on a 60 percent fall in the value of the Ukrainian hryvnia currency this year, with gross domestic product down 18 percent in the second quarter and bad loans amounting to 30 percent of all lending.

The Insurance Insider revealed in November that following the series of bank collapses in Ukraine earlier this year, industry loss estimates from the country are now in the region of $500mn.

Meanwhile, the International Monetary Fund (IMF) was poised last month to dish up $3.8bn in funds to stabilise Kiev's gathering financial crisis.

The IMF had held back from releasing the funds after Ukraine's parliament passed a bill raising the minimum wage by over 20 percent.

State gas firm Naftogaz defaulted on a $500mn Eurobond in October before restructuring, while national railway company Ukrzalyznitsya restructured a $550mn syndicated loan arranged by Barclays after failing to repay $110mn.

UK government criticises 'Big Three'

Trade credit insurance has entered the lexicon of mainstream UK politics – particularly after high street institution Woolworths blamed the removal of this finance for its supply chain snarl up and insolvency – with Westminster launching a £5bn state support scheme in May.

Levelling his sites on the sector's Big Three – Euler Hermes, Atradius and Coface – Mandelson said the scheme would have benefitted from support from the trade credit market.

"It would have been much better if the three main credit insurers had been more forthcoming in supporting the market for trade credit insurance," he suggested.

A mere £18mn of this fund has been taken up by just 72 small British companies.