The trade credit village just got smaller. Does the Zurich exit matter?

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Departures from parts of the trade credit and CPRI market – in particular by Zurich and QBE – have raised eyebrows as reduced capacity could make it harder for banks to secure a programme with a single insurer. What will be the impact, and can improved harmonisation of Basel-compliant documentation help bolster capacity?

"Trade credit insurance is a cottage industry," says Scott Ettien, executive vice president and global head of trade credit at Willis Towers Watson (WTW) at ITFA's 47th annual global trade and forfaiting event in Bristol. "It will remain a small industry, as regards capital relief substitution, unless the industry can come together and agree on standard wording which banks, law firms and regulators can support. There are too many forms in the market today and thus this makes it a challenge for regulators to amend current requirements for substitution requirements.

Two market participants (QBE and Zurich) have recently withdrawn from the trade credit market in the US, which will further challenge insurance support as over $20 billion of capacity was removed. This will drive the need for more insurer syndications to meet capacity demands, therefore, standardised and consistent wording will be paramount."

In total, three players have recently departed parts of the market. "AWAC, QBE and Zurich have left the market, but that's more than made up for in the form of new entrants," said one banker on stage at the same event. The news of QBE's exit went to all trade credit brokers in North America, and it was a much larger player in that market than was Zurich. "QBE moved out of the US but it was widely known in the market," confirmed another former broker. But it was Zurich's exit that has caused most discussion in the village.

Zurich's surprise exit

Zurich's departure was more of a surprise, although not to all. Zurich told one broker, " we have ceased short term trade credit with immediate effect and are conducting a phased withdrawal of CPRI [as the product] is no longer deemed strategically core business for the group. The trade credit team in Germany and the surety offering will remain unaffected as they operate under a different model."

That the offering was no longer seen as core business was interesting. Multiple sources have asserted that the decision was about capital costs and returns rather than any upturn in claims.

"Zurich had a $200 million business which shrank to a £30 million business," says a former broker who did not want to be named. "We had seen Zurich zig in and out of the business for quite a while and they were widely regarded as not giving good terms for some time. They have been running down their book – so it's business as usual for a while, but it is disappointing, though not wholly unexpected. When I spoke to them they admitted to some mistakes in the market and some decisions that were not optimal."

Zurich has subsequently asserted it had withdrawn from the standalone political risk market and was running down its global trade credit business. It confirms it is winding down its short term multi-buyer (STMB) insurance portfolios, except in its home countries (Germany and Switzerland). It will continue short-term trade credit insurance its home markets, some UK customers through Germany and some clients in other EU countries, but that it will not be writing any new STMB policies out of the UK or US.

The world is evolving – could the village continue to grow?

Nonetheless, the trade credit insurance market remains robust, and continues to develop. "The biggest growth in the last five years has been bank programmes from trade credit insurance – such as SCF and payables programmes. The capacity grew and it drove many insurer syndications and bank participations," says Ettien. The expected losses due to the pandemic did not materialise to the extent expected and the credit insured bank programmes came through magnificently. All trade credit insurers provided latitude to help banks and their customers to negligible or zero loss ratios. This was a great test for bank driven programmes and further cements that SCF and other monetisation programmes will continue to drive growth in the trade credit industry."

Harmonising documentation – towards a more collaborative market?

Ettien is one of the drivers behind a new policy wording form, launched at the ITFA event, that is a starting point for helping standardise policy wordings to help in syndications of bank programmes in collaboration with insurers and lawyers in line with Basel III policies. The template policy wording is being promoted as an alternative to, not a replacement for, a current form negotiated by a bank for their insurance placements. This harmonised form may be needed for insurer syndications due to the need for consistent wording. "It's also a very good resource for new banks entering this space as it will streamline their education and negotiations to agree an insurance policy for substitution purposes," Ettien notes.

Trade credit insurance has been impacted by legislative changes, the Basel Accords and regulatory capital relief. "This new form is designed to cover receivables policies but should also be viewed as a strong platform for devising compliant policies for other situations and products," ITFA notes in a statement. The process has taken more than three years from the original template and took input from more than 45 firms, including insurance companies, banks, law firms and brokers.

A more harmonised approach to common wording areas will help reduce duplication of effort and create better efficiencies. It will also improve transparency amid Basel III/IV wording as this form will evolve via the ITFA insurance committee to address any material changes in the Basel Accords. Bank participations using this form should allow all banks to receive capital relief in line with Basel III. "While this document is a first step, work is still needed to complete the mechanics of the deal," says Ettien. "The insurers will need to issue separate policies to each bank to satisfy the control feature but we have to create the schematic of how this all ties together with a lead bank and participant banks. The end result should be that all banks have their own policy but act in unison when filing past dues, filing claims, paying premium, etc."

This should have a positive impact for banks to obtain greater capacity in the market. Nonetheless, the document is very much seen as a 'starting point' as negotiations will still take time and a standard cookie-cutter Basel III policy will never exist because of the nuances of each deal that mandate changes in definitions [for instance, 'eligible receivable', etc]. However, the four corners of Basel III eligibility requirements, for instance, exclusions, reps and warranties, etc. should remain consistent/boilerplate as the UK Insurance Act, for instance, is set in stone."

This document will help with guidance to further explain a Basel policy to investors on why certain decisions are made. ITFA will soon release guidelines for this policy document.

A larger role for trade credit insurance?

Going forward, Ettien hopes that there will be a larger role for trade credit insurance for bank programmes. “All ships rise if we collectively get the market to rise – and there will be more opportunity for all. I feel that the broker role should evolve to further shape the industry as brokers have strong relationships with both the insurers and their customers. Our broker role is to further educate both sides and drive the change needed for all to prosper. Working in isolation in this specific area may jeopardise the fiduciary responsibility we all have for our customers and, therefore, standardising the documents and bringing transparency to this part of the credit insurance market, will not only raise the bar but set up insurers, banks, law firms and brokers for future growth.”

“Trade credit insurance is a tremendous tool to help collateralise bank driven programmes. Most, if not all, insurers in this space are investment grade firms. Enhancing a programme with an investment grade insurance wrap relieves capital allocation requirements for the banks and makes risk transfer to the insurers a secondary driver behind the capital substitution aspect. That’s a big deal as the bulk of the insurer programs are corporate policies and risk mitigation is the driver for the purchase, not the by-product,” Ettien enthuses.

Does that mean the cottage industry will change? Perhaps. The exit of QBE and Zurich in the US places further strain on capacity available in the market. Capital relief drives bank competition and an insurance product that makes this easier could be good for all involved. It will take time to move the pendulum towards standardisation and the push by brokers such as WTW and ITFA has started.