The Impact of the Financial Crisis on the Credit Insurance Market

Financial markets are characterized by severe problems of asymmetric information between the parties involved in a transaction. In terms of credit this means, for example, that the borrower has much better information about his/her risk profile and therefore the probability that s/he will repay a loan than the lender. Many forms of contractual solutions have been developed in order to overcome these problems. However, even with these contracts, it is not possible to realize all socially beneficial transactions, meaning that market failure does occur. Therefore, areas do exist in which the government intervenes. During the recent financial and economic crisis the information problems causing market failure have become even more severe than in ordinary times, raising the scope for government intervention. One example are failures in the market for credit insurances. In this article we review how governments have reacted and altered their involvement in the credit insurance market as a result.

Credit insurance is used for different types of loans. Firstly, it can be related to a trade credit.[1] If a supplier grants a trade credit to his customer, he asks his/her buyer for a guarantee from his/her bank. Thereby, the risk that the buyer cannot pay for the goods supplied is shifted from the supplier to the buyer's bank. The bank charges a commission on the bank guarantee and takes into account that it has a contingent liability when determining the buyer's credit limit. Secondly, credit insurance can be related to a bank loan and here, most of the time, to the financing of export related activities. Suppose a firm exports goods or services. As in the case with a domestic customer, the firm may need a bank loan for the working capital financing of this activity or the firm grants trade credit to its customer and finances its resulting liquidity requirements through

[1] For firms, trade credit is a major source of short-term credit (OECD, 2011).

Table 1

Intervention in Credit Insurance Markets - Protection for Domestic Receivables

	New coverage				Comment [a)]
	Domestic	Top-up	Generalised	Other	
Austria					
Belgium	●	●			Indirect using SFI.
Czech Republic					
Denmark					
Finland					
France	●	●	●		Indirect using SFI (CCR).
Germany	●	●			Indirect.
Ireland					
Luxembourg					
Netherlands					
Portugal					
Spain	●	●			Indirectly through SFI (CCS).
Sweden					
United Kingdom	●	●			Indirect.
Norway					Short-term credit insurance already provided by SEA.
Canada	●	●			Indirect using SEA; direct SEA provision to automotive sector.
Japan					
New Zealand					
United States					

Symbols: ● = Yes.
For those columns where no symbol has been inserted, assume a "No" response. This approach is taken to ensure a clearer presentation of responses.
[a)] Reference to "indirect" means that provision is through private sector.
SFI = State financial institution; SEA = State export agency.

Source: OECD, 2011.

Table 2

Intervention in Credit Insurance Markets - Protection for Export Receivables

	Export	New coverage		Other	Comment [a]
		Top-up	Generalised		
Austria	●	●	●		Direct by SEA and indirect through reinsurance by SEA.
Belgium	●	●			Indirect using SFI; for EEA only.
Czech Republic	●			●	Increased state risk retention (to 99%).
Denmark	●	●	●		Indirect: reinsurance via SEA.
Finland	●	●			Direct by SEA.
France	●	●	●		Indirect.
Germany	●	●			Indirect via industry consortium.
Ireland					
Luxembourg	●	●			Indirect via SEA.
Netherlands	●	●			Indirect via reinsurance.
Portugal	●	●			Indirect.
Spain	●			●	Indirectly through pools.
Sweden					
United Kingdom					
Norway	●	●			Short-term credit insurance already provided by SEA for all countries.
Canada					
Japan					
New Zealand	●	●	●		Direct and indirect via reinsurance through SEA.
United States	●			●	Reduced premium rates and increased coverage for SMEs.

Symbols: ● = Yes.
For those columns where no symbol has been inserted, assume a “No” response. This approach is taken to ensure a clearer presentation of responses.

[a] Reference to "indirect" means that provision is through private sector.

EEA = European Economic Area; SFI = State financial institution; SEA = State export agency; SME = Small and Medium Enterprise.

Source: OECD, 2011.

a bank loan. The risk of financing customers abroad, however, is higher as they are farther away and reside in a different jurisdiction. Depending on the country in which the buyer is located and on the product or service traded, there can be significant political risks in such a deal.[2] Banks only accept risks up to a certain level and therefore they are often not willing to grant loans that bear a high level of political risk. Many governments created export credit agencies that take over the political risk such that risk comes down to a level that banks are willing to bear. Through such measures governments can improve the competitive position of their exporting firms (Felbermayr and Yalcin, 2011). During the recent crisis, however, credit insurance agencies started to reduce their exposure as they experienced higher losses (OECD, 2011).

The following tables summarize the interventions of governments in the credit insurance market. There are two tables, one for the protection of domestic receivables, the other for export receivables. They contain information on 19 OECD countries. Six countries changed their policy with respect to credit insurance of domestic receivables during the crisis (Table 1). Belgium, France, Germany, Spain, United Kingdom and Canada provided new coverage by topping-up existing programs, while only France generalized its support scheme. Most of the time, the support was granted through the private sector, which itself obtained guarantees or could use reinsurance schemes from a state financial institution. Sometimes (for example in Canada) the state export agency started to support domestic transactions as well.

In more countries the respective government engaged in activities protecting export receivables (Table 2). In most cases existing programs were topped up, for instance, by increasing the amount of coverage or granting guarantees to firms that were

[2] Political risk varies over products and services traded. For example, some industries (such as infrastructure or telecommunication) are often state-owned or regulated and therefore suppliers face a higher degree of political risk (for the relationship between political risk and the syndicate structure of loans, see Hainz and Kleimeier (2012)).

Table 3

Intervention in Credit Insurance Markets - Actions to Support Credit Insurance Markets (in Selected Countries)

	Remarks
France	3 temporary programmes have been established by the French government to support private credit insurance markets, both for domestic business as well as for export-oriented business. All three programmes involve some sort of state reinsurance or guarantee mechanism: • The Complément d'Assurance-crédit Public (CAP) is intended to ensure the continued availability of credit insurance for suppliers dealing with small to medium-sized purchasers (less than EUR 1.5 billion in revenues). Businesses that find their credit insurance coverage cut by private-sector credit insurers due to their exposures to these types of purchasers can obtain a CAP guarantee that provides coverage up to 50% of the original coverage amount (as of 1 October 2008). This program allows businesses to retain 100% of their original coverage so long as private insurers do not cut their coverage below 50% of the original amount; any coverage reduction greater than 50% means a reduction in CAP coverage to ensure 50/50 risk-sharing with the private sector. CAP amounts insured by credit insurers are reinsured directly with the Caisse Centrale des Reassurances (CCR), France's state owned natural catastrophe reinsurer. CAP is offered on a 3-month renewable basis, with higher-than-average-market premiums charged (1.5% of receivables versus an average market rate of 1%; 0.3% is given to the credit insurer for commercialisation and brokerage of the CAP, 1.2% to the CRR) to reflect the risk undertaken by the CCR. The CAP became operational in December 2008. The state's guarantee to the CCR for the CAP is capped at EUR 10 billion and is expected to expire on 31 December 2009. With the establishment of the CAP programme, the private-sector credit insurers agreed to the following commitments as a means to promote confidence between credit insurers and their clients, and improve transparency in the market, namely: – Systematically propose the CAP to firms; – Not reduce, globally, the percentage of receivables of French firms that they insure over the next 6 months; – Provide to the government, every month, statistics on the level of insured receivables, with specification of the extent to which the receivables of small and medium-sized businesses are insured; – Re-examine, within 5 days, any file transmitted to the French national credit mediator regarding a firm experiencing a cut-back in coverage; – Not proceed with cutting back coverage on a sectoral basis with taking into account the individual circumstances of each firm; – Systematically provide a rationale for any decision to modify coverage for any given risk – Provide necessary explanations to those businesses seeking information on how the credit insurer's evaluation of the individual business is evolving. • The CAP+, established in May 2009, responded to concerns about: (a) cancelled credit insurance coverage – thus disabling a previously insured business' access to CAP; and (b) the inability of non-insured businesses to access any credit insurance to protect themselves against new-found risks posed by the financial crisis. Coverage under CAP+ is provided to businesses transacting with small or medium-sized businesses (same revenue threshold as CAP) that have seen their coverage fully withdrawn or that are seeking to secure coverage, and whose default rate over a 1 year period is expected to lie between 2 to 6% (deemed to be a low enough default rate to avoid undue exposure by the state to firm insolvency risk, but a high enough rate to prevent CAP+ from insuring risks that can be covered by industry). The CAP+ is organised differently from the CAP. It is set up as a credit insurance guarantee fund capable of covering EUR 5 billion worth of receivables on an annualised basis, and is administered by the CCR. Insured parties retain 20% of losses, with the remaining losses retained by the state, through the CCR, up to a EUR 600 million threshold on the CCR's share of losses; in excess of this threshold, credit insurers then absorb 10% of losses. The private-sector credit insurers are responsible for the commercialisation of CPA+ but do not retain any risk (subject to the threshold mentioned above); instead, all amounts insured under CAP+ are transferred directly to the account of the guarantee fund. The French government has to date committed to injecting EUR 200 million into the CAP+ guarantee fund. The level of coverage that can be obtained is determined by the applicant, but a ceiling is placed on the amount of credit insurance per counterparty (EUR 200,000 for less risky counterparties, EUR 100,000 for riskier counterparties), with the maximum indemnity per insured business being EUR 3 million. Credit insurance is provided only on 3-month renewable basis and costs an annual 2.4% of receivables (0.6% is given to credit insurers for commercialisation and management of the guarantee, and 1.8% to the CCR). At least 20%of the risk must be retained by insured business as a means to align incentives. The CAP+ was seen as a temporary measure and is due to expire on 31 December 2009. • CAP Export was established in October 2009 to support small and medium-sized enterprises (similar threshold as in CAP/CAP+) based in France and exporting abroad. CAP Export effectively provides two types of guarantees on a 3-month renewable basis, similar to CAP and CAP+: as with CAP, it can provide coverage to exporters that have seen a reduction in their export credit insurance coverage, up to 50% of their original coverage; in addition, CAP+ provides coverage for exporters that have lost their coverage entirely or for exporters seeking coverage but unable to obtain it, and where the probability of default of the counterparty over the next year lies between 2 and 6%. CAP Export is administered by the private-sector credit insurers and is supported by a state guarantee; Co face, a private-sector credit insurer, manages the risk for the state guarantor, that is, the French Treasury. Additional notes: – Credit insurance covers roughly 1/4 of receivables in France, or approximately EUR 320 billion. A majority of risks covered by credit insurance are linked to small and medium-sized companies. – A private-sector credit insurer, Co face, has noted that for every EUR 5 of short-term credit given to firms, EUR 1 comes from banks while EUR 4 come from suppliers (RiskAssur - hebdo, 30 March 2009). – Building and public works sector is seen as particularly hard hit by non-payment for goods and services rendered in the crisis. – Take-up of CAP and CAP+ as of 9 October 2009: EUR 448 million guaranteed receivables under CAP and 14,986 activated files; EUR 491 million guaranteed receivables under CAP+ and 23,620 activated files. Amounts insured on average are relatively modest: EUR 30,000 for CAP and EUR 20,000 for CAP+. Roughly 38,000 commercial relationships have reportedly been protected by CAP and CAP+.

Table continued

Germany	The federal government has established a temporary export credit insurance scheme that offers state short-term export credit insurance to German exporters that are confronted, due to the crisis, with unavailability of trade credit insurance cover in the private market for financially sound transactions. This scheme involves the extension of the already existing state export credit guarantee scheme. The existing public scheme offers state insurance for short-, medium- and long-term export transactions. However, in case of the short-term transactions, public cover was offered only for exports to countries defined as non-marketable. The state-sponsored insurance will be offered by Euler Hermes Bund to companies established in Germany, with no limitations regarding to the groups of products or sectors covered. That said, coverage will be offered for four main types of products: Whole Turnover Policy (APG) (or in simplified form for SMEs as Export Whole Turnover Policy light), Supplier Credit Cover (single or revolving) and Manufacturing Risk Cover. The standard policy offered by the private credit insurers in Germany is the whole-turnover policy, where all exports by the company is covered up to an agreed turnover limit. Exporters will, in principle be required to retain 10% of the risk, but they may apply for a reduction to 5% (this reduction of risk retention by the exporter is available only until 31 December 2010, though the government reserves the right to increase the exporter's retention to a maximum of 35% should the risk assessment of the buyer identify a heightened risk). The remaining risks will be covered by the government. Euler Hermes does not retain any risk related to the coverage provided under the scheme. Export transactions that are insured must be justifiable in terms of the commercial and political risk involved. These include the financial strength and economic policies of the country concerned, as well as macro-economic and political factors, as well as the foreign buyer's creditworthiness and payment record. The scheme will not be applied to buyers in economic difficulties or to buyers with a weak or insufficient solvency. The scheme will be administrated on behalf of the federal government by a private-sector consortium consisting of Euler Hermes Kreditversicherungs-AG (Euler Hermes Bund) and PricewaterhouseCoopers AG WPG – the same consortium that manages the public German export credit insurance system. The Consortium will receive the applications for cover, conduct risk assessment, take the decisions to provide coverage on behalf of the state for export contracts up to EUR 5 million (or prepare decisions on applications for consideration at the meetings of the Inter-ministerial Committee (IMC) for contracts exceeding this threshold), and handle claims. The Consortium will receive around EUR 55-68 million for administration, depending, inter alia, on the volume covered transactions. A strict "Chinese wall" will exist between the activities of Euler Hermes as a private credit insurer (Euler Hermes Private) and the Consortium (in particular Euler Hermes Bund). This translates to separation of accounts and administration between those parties. Moreover, no exchange of credit information on individual foreign buyers takes place. In addition, Euler Hermes Private is not in a position to shift risks which are difficult to accept on own account to the Consortium. The same system of premium rates will be applied as the one, which defines the level of premium for the State insurance cover for the non-marketable countries in the normal market conditions. The premium to be paid by the exporter for the insurance cover within the notified measure varies according to the category of the country, in which the buyer is based, his creditworthiness, nature of risk covered and the type of the policy. The annual remuneration due to the Consortium for the administration of the public scheme with the total budget of up to EUR 117 billion is estimated at around EUR 55-68 million and depends, inter alia, on the volume covered transactions. This corresponds to all administrative costs and a management fee for the Consortium related to the administration of the whole State export credit guarantee scheme covering both non-marketable and temporarily non-marketable risks. The public short-term export credit insurance cover is available to all exporters established in Germany until 31 December 2010. In December 2009, the federal government set up a guarantee scheme that offers top-up cover in the trade credit insurance. The guarantee scheme has a total volume of up to EUR 7.5 billion and will expire on 31 December 2010.
Spain	The Spanish government has undertaken two initiatives in relation to credit insurance, one oriented toward the domestic market, the other oriented to the export market: • In March 2009, the Spanish government introduced a special measure to reinforce the capacity of the private credit insurance market in Spain. The government authorized the Consorcio de Compensación de Seguros (CCS), a state-owned reinsurer responsible for compensating insurers covering extraordinary risks, to reinsure credit and bond risks covered by domestic credit and bond insurers. The value of transactions supported by this initiative could reach EUR 40 billion. The CCS and UNESPA (the Spanish insurance association, Associación Empresarial del Seguro) reached an agreement by which EUR 20 billion worth of credit transactions could be supported in 2009. The CCS agreed to cover 85% of losses on credit insurance contracts insofar as the loss rate on these contracts lies between 85% and 130% of premiums paid. This could lead to a loss of up to EUR 200 million, with the net loss being no more than EUR 170 million for the CCS. This agreement will be in effect for 3 years. It includes the major domestic credit insurers except Euler Hermes. • The government, through the Compañía Española de Seguro de Crédito a la Exportación (CESCE), has sought to introduce greater flexibility into its ability to support export credit insurance, including the creation of a special facility for providing coverage of "pools" of small and medium-sized firms in association with sectoral associations and chambers of commerce (CESCE-PYME). The government has presented a plan to Parliament that would establish a scheme for the CESCE similar to that for the CCS that would provide coverage of EUR 9 billion worth of export credit insurance policies.
United Kingdom	The UK government introduced a Trade Credit Insurance Top-up Scheme (TCITS) that became operational in May 2009. The TCITS enables any UK firm with a credit insurance whole turnover policy that has seen a reduction in its coverage with respect to a particular purchaser to purchase additional insurance with respect to that purchaser. The scheme does not apply to firms that have seen their underlying cover fully removed. The scheme only applies to trades taking place within the UK and thus excludes export transactions. The scheme is administered by the private sector on behalf of the government and will be in place under 31 December 2009, after which no top-up policies will be offered. The aggregate level of top-up insurance provided under the scheme is capped at GBP 5 billion. Top-up coverage is available if the: • the underlying cover is in respect of trades taking place within the UK; • the trades covered by the insurance have payment terms of no more than 120 days, and any pre-shipment coverage included in your underlying policy terms is of no more than 120 days; • the original level of cover was in place for at least 30 days; • the reduction in the level of cover happened either on, or after, 1 October 2008; and, • the reduction in the level of cover was instigated by the credit insurer – and not at the request of the insured.

Table continued

United Kingdom	Up to 28 days' retrospective cover can be purchased in circumstances where a business requires continuity of cover from a partial reduction made by insurers in the previous 28 days. Top-up policies can be bought under the government scheme for a period of 6 months. The coverage that can be obtained is the lower of the following amounts: • the amount that restores the level of cover to the amount previously held; • the amount equal to the level of cover now offered under the credit insurance policy; or, • GBP 2 million. If the underlying cover is full withdrawn, then the top-up cover will be terminated. Transactions already covered will continue to be insured under the top-up scheme, but no new transactions will be covered. E.g.: • If cover provided by the underlying policy is reduced from GBP 100,000 to GBP 80,000 then top-up cover of GBP 20,000 can be purchased to restore cover to the original level of GBP 100,000. If cover subsequently reduces to GBP 50,000, then an additional top-up cover of GBP 30,000 can be purchased, bringing the value of the top-up policy to GBP 50,000, restoring the total level of cover to the original level of GBP 100,000. • However, if the underlying cover subsequently falls below GBP 50,000, for example to GBP 20,000,then the level of cover provided by the top-up policy will fall to match the amount provided by the underlying policy, in this case GBP 20,000. The total level of cover will therefore be GBP 40,000. The (6-month) premium rate for top-up cover is 1% of the level of top-up cover provided under the scheme at the time when the firm joined the scheme. An administrative charge is applied by the credit insurers administering the scheme. If the case arise where it is possible to purchase additional top-up coverage, then premium amount will increase (based on extra amount needed and amount of time remaining on the policy). If the underlying cover falls during the first 3 months, then a refund on the premium paid is possible (1/3 multiplied by the difference between the higher level of cover and the lower level of cover provided under the top-up policy during this period). Beyond 3 months, no refund is possible. Firms with top-up cover are permitted to change credit insurers as long as the credit insurer to whom they are transferring their business is also part of the scheme, and disclosure is made of the use of top-up policy. All credit insurers participating in the government scheme adhere to a statement of principles, published by the Association of British Insurers that outlines the behaviour of credit insurance providers. Changes have been made to the scheme since its introduction, e.g.: backdating of retroactivity to 1 October 2008, instead of 1 April 2009; reducing premium rate from 2% to 1%; abolishing minimum amount of top-up coverage (GBP 20,000); and increasing maximum top-up cover from GBP 1 million to GBP 2 million. No known changes have been made to the Export Credits Guarantee Department's (ECGD) export credit insurance policy, which is available for transactions valued at more than GBP 20,000 involving capital goods, provision of services, or construction projects (transactions involving consumer goods or commodities on short payment terms are excluded). No coverage is provided for developed country markets. Additional notes: – In 2008, credit insurance firms insured over GBP 300 billion of turnover, covering over 14,000 UK clients in transactions with over 250,000 UK businesses. – As of 2 September, 52 companies had benefited from GBP 1.1 million in coverage (viewed as too low).
Japan	In response to the financial crisis, the following measures have been introduced, amongst others: 1. Financial support for business by Japanese overseas subsidiaries: The following support will be available through the end of March 2010 by the Nippon Export and Investment Insurance (NEXI) to meet the needs of Japanese overseas subsidiaries: • Support for working capital: Overseas Untied Loan Insurance (OULI) will be available to loan financing for Japanese overseas subsidiaries as their working capital with 1-year term or longer (currently OULI is available to loan financing for investment capital only for a 2-year term or longer). • Increase of commercial risk cover: The percentage of commercial risk cover of OULI to loan financing for Japanese overseas subsidiaries will be increased up to 90% from the current level of 50%. • Cover with parent company guarantee: OULI will be extended to loan financing to Japanese overseas subsidiaries based on the credit worthiness of their parent companies if guarantees are provided by the parent companies. 2. Insurance cover for supplier's credit: The Japan Bank for International Cooperation (JBIC) launched, as an exceptional temporary measure, a facility for export credit insurance, to be made available for exports to developing countries with deferred payment. Loans will also be made available for investment projects in developing countries through major Japanese companies (overseas investment loans). Separately, JBIC launched a financing facility that provides loans and guarantees to Japanese firms (including small and medium-sized enterprises) to finance their business operations in industrial countries - normally such facilities are provided only for firms operating in developing countries. Eligible businesses are defined as: "the business categories determined by the competent minister to belong to the industries that are experiencing significant difficulties in promoting the government policy of maintaining their international competitiveness due to the global financial turmoil".
United States	In October 2008, the Export-Import Bank of the United States (Ex-Im Bank) reduced its premium rate by 15% on two types of export credit insurance: short-term small business multibuyer policies (designated as ENB), and short-term small business environmental multibuyer policies (designated as ENV). The premium rate reduction, effective Oct. 1, 2008, affects approximately half of all Ex-Im Bank insurance policy holders. In November 2009, the Ex-Im Bank raised the upper limit of its small business multibuyer export credit insurance policy. The eligibility ceiling was raised from USD 5,000,000 to USD 7,500,000. Other policy enhancements include: 1) no first loss deductibles, 2) discounted insurance premiums, and 3) the receipt of cost-free, exporter performance risk protection for lenders financing receivables for qualified exporters. The broadened program eligibility will be effective 1 December 2009. Current Ex-Im Bank multibuyer policy holders, who previously were ineligible for coverage enhancements but are eligible under the new ceiling, will be offered conversions to the enhanced policy.
Notes: EEA = European Economic Area; SME = Small and Medium Enterprise.	

Source: OECD, 2011.

not eligible before. In Japan, for instance, support became also available for business operations in industrial countries; before it was restricted to developing countries, but there was a wide range of other measures as well (see Table 3). In many cases the existing state export agencies were the agents for providing the supporting measure. However, there are countries in which private credit insurances could reinsure themselves from the government so that support was transferred indirectly. Interestingly, nearly all governments that intervened in the credit insurance market for domestic receivables did this in the market for export receivables as well. The United Kingdom is an exception because it only altered its policy with respect to domestic receivables.

In addition to these two tables, the DICE Database contains a table showing details of which actions were taken to support the credit insurance market in all of the 19 countries. Information in this table is very detailed and it is therefore beyond the scope of this article to offer such information for all countries. Here, to give the reader an idea of the information provided, Table 3 shows selected countries only (France, Germany, Spain, United Kingdom, Japan and the United States).

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