Trade credit, bond and political risk: A state of the market summary

Guy Carpenter's David Edwards examines the state of play in the credit and political risk market and looks ahead to January's renewals

Against a backdrop of growing economic and political risks in recent years, loss ratios in the trade credit, bond and political risk business have remained exceptionally low across the market, with marginal upticks in some instances, but no widespread major increases as of yet.

While other reinsurance classes have hardened, the prevailing sentiment in this segment has been a sense of realism about rate developments, with insurers more focused on favourable conditions and capacity than price. Insurers value long-term relationships with reinsurers over pushing for marginal rate movements, especially in times when they are hard to achieve.

Overall, despite a general over-supply of reinsurance capacity for credit risks, there has been under-deployment by reinsurers, which remain more cautious than insurers about the risk environment.

Inflation more of a concern than major events

While a recession was widely anticipated in 2019/2020, no one expected it to be instigated by a global pandemic. The post-Covid-19 restructure was very challenging for the market, but losses due to the pandemic did not come through instantly, owing largely to widespread government support given to businesses, which led to a low default rate among companies. At the same time, insurers had already rewritten their portfolios in anticipation of possible defaults.

Meanwhile, the effect of inflation has been to drive premium volume up, as risk limits and insured turnover grows. This leads to capacity challenges for many of the established reinsurers, with some small to mid-sized reinsurance players seeing this as an opportunity to step in. At the same time, inflation is contributing to increasing loss severity.

Loss deterioration a challenge for surety

There are some growing challenges to political risk carriers in terms of loss deterioration on emerging market/sovereign type-exposures. This is caused largely by energy and raw materials costs associated with the Russia-Ukraine conflict.

However, the surety market also faces a significant challenge in this regard, due to the impact of fixed-price contracts, supply-chain issues and rising interest rates, with the US, UK, Scandinavia and Australia some of the worst-affected markets to date.

While there is some clear evidence of an uptick in claims activity, the overall impact remains limited. Some sub-products, regions and insurers are being affected more than others by loss developments. Overall, we expect the current upward claims trend to continue, but to remain within cycle norms other than for certain localised instances, where severity will be the driver.

Rating dynamics will change year on year

Renewals at 1 January 2024 are likely to begin from a narrower base compared with 2023, with the most likely scenario being stability on average for the market. But the range between the high and low is expected to spread for a variety of factors, in particular the performance of individual cedants.

Overall, there is a shared appetite from insurers and reinsurers to grow in specialty lines to dilute volatility in other classes, which should improve market dynamics for trade credit, bond and political risk. Strong new business opportunities should drive continuing improvements in average portfolio quality for the market as a whole, helping to reduce the overall market volatility further.

Preparing for January renewals

In the current risk environment for trade credit, bond and political risk, the ability of insurers to demonstrate a strong risk management focus will be critical.

While it might appear axiomatic to say that data is central to successful reinsurance buying, there is no doubt that quality data is more valuable than ever. There will be even greater onus on cedants to provide the maximum possible data, particularly for specific distressed exposures, with detailed quality data provided early being indispensable for generating the best outcomes. Guy Carpenter helps clients anticipate and navigate an ever-changing marketplace.

David Edwards is co-head of the credit, bond and political risk division at Guy Carpenter