Article Title: Criteria | Insurance | Specialty: Trade Credit Insurance Capital Requirements Under S&P; Global Ratings' Capital Adequacy Model Data: (EDITOR'S NOTE: —On Feb. 26, 2021, we republished this criteria article to make nonmaterial changes. See the "Revisions And Updates" section for details.) I. INTRODUCTION 1. This article presents S&P; Global Ratings' criteria for evaluating the capital requirements for trade credit insurance under its capital adequacy model. Trade credit insurance insures manufacturers, traders, and providers of services against the risk that their buyer does not pay (after bankruptcy or insolvency) or pays very late. 2. Given the particular characteristics of trade credit insurance, we use outstanding risk exposure to tailor specific capital requirements for the sector. These criteria supplement "Refined Methodology And Assumptions For Analyzing Insurer Capital Adequacy Using The Risk-Based Insurance Capital Model," published on June 7, 2010. The capital requirements specified in this article replace the relevant property/casualty premium and reserve capital requirements in appendixes 3-7 of the June 7, 2010 article. 3. In the absence of specific criteria, we also apply these criteria in our capital adequacy analysis of lines of business that have similar characteristics to trade credit insurance, such as surety, surety bond, bond and bonding insurance; and for insurers for which these lines are material. II. SCOPE OF THE CRITERIA 4. These criteria apply globally to the analysis of trade credit insurance and similar lines of business, where these lines are material to the insurer. III. SUMMARY OF THE CRITERIA 5. These criteria provide the exposure-based capital requirements we use in our capital adequacy analysis of trade credit insurance businesses. 6. This paragraph has been deleted 7. This paragraph has been deleted. IV. METHODOLOGY 8. For trade credit insurance, we replace the relevant capital requirements for premium and loss reserves in our capital adequacy model with an exposure-based requirement. This requirement is the product, after mitigation, of: The insurer's highest gross incurred loss as a proportion of its averaged gross exposure over the past 10 years (where a company does not have a 10-year history, we may look at peers' data); The insurer's gross exposure at its latest year-end; and An economic stress factor of either 1.25x or 1.00x. 9. An insurer's averaged gross exposure is its insured loss applicable under each policy outstanding, averaged over the past two year-end exposures. It is calculated before deducting any policyholder retentions and reinsurance. 10. The mitigation relates to the insurer's policyholder retentions, reinsurance protection, and similar mitigating factors. Calibration 11. When we consider that the global economic credit stress for the past 10 years is 'BBB' or more, we set the economic stress factor at 1x; otherwise, it is 1.25x. We selected the 10-year period because it typically captures a high proportion of an economic cycle, but does not include major changes to credit insurers' offerings. This produces a capital requirement at the 'BBB' confidence level. 12. To determine capital requirements at the 'A', 'AA' and 'AAA' confidence levels, we increase the 'BBB' capital requirement by 1.32x, 1.45x, and 1.63x, respectively. We based these figures on our research into defaults in fixed-income securities. The increase reflects the scaling applied to property/casualty premium and reserve risk charges in our risk-based capital model. Table 1 provides an example of the calculation. Table 1 Example Of Trade Credit Insurance Capital Requirement For Year-End 2013 (000S $) 2013 2012 2009 2005 2004 Average gross exposure 200,000 190,000 150,000 110,000 100,000 Gross incurred loss (reported during year) 1,200 1,100 2,000 600 500 Gross incurred loss/average gross exposure (%) 0.6 0.6 1.3 0.5 0.5 Worst-observed full gross incurred loss/gross exposure in past 10 years (2009*) (%) 1.3 Apply to gross exposure 2,666 Deduct client retention (400) Deduct quota-share reinsurance (800) 'BBB' capital requirement 1,466 'A' capital requirement ('BBB' x 1.32) 1,935 'AA' capital requirement ('BBB' x 1.45) 2,126 'AAA' capital requirement ('BBB x 1.63) 2,390 *Standard & Poor's deemed 2009 to be a 'BBB' global economic credit stress. Mitigating factors 13. We reduce the exposure-based requirement to take into account certain types of reinsurance protection; chiefly, this applies to proportional reinsurance. We reduce the requirement by the contractual proportion, subject to any limit. A reduction also applies where an insurer has taken out whole-account stop-loss reinsurance that provides similar protection to proportional reinsurance, that is, it has appropriately low deductibles and high limits. 14. For example, we would apply a full reduction for reinsurance where a trade credit insurer with a loss ratio before reinsurance of 125% in one of the past 10 years and an average loss ratio of 65% took out reinsurance with a 55% or higher loss ratio deductible and a 70% loss ratio limit. (The loss ratio is incurred claims as a percentage of earned premium). However, we would be unlikely apply any reduction to the same insurer if it took out reinsurance with a 125% or higher loss ratio deductible. 15. No reduction for excess-of-loss reinsurance applies, but it may be significant enough to influence our assessment of the insurer's risk position. 16. Reductions for non-reinsurance mitigating factors (such as insurance-linked securities) may also apply, to the extent that they mimic reinsurance, using the principles in paragraphs 13-14. 17. Our analysis may assign qualitative credit where mitigation (such as excess-of-loss reinsurance) is not recognized quantitatively, if we assess the additional protection as material. REVISIONS AND UPDATES This article was originally published on Dec. 6, 2013. These criteria became effective upon publication. These criteria partially supersede appendixes 3-7 of "Refined Methodology And Assumptions For Analyzing Insurer Capital Adequacy Using The Risk-Based Insurance Capital Model," published on June 7, 2010, and supersede "Credit And Surety Insurance Criteria: Interactive Rating Methodology," published on Oct. 18, 2004. Changes introduced after original publication: Following our periodic review completed on Jan. 8, 2016, we updated the author contact information. Following our periodic review completed on Jan. 5, 2017, we updated the contact information and deleted paragraphs 6 and 7, which were related to the initial publication of our criteria and no longer relevant. On Feb. 24, 2020, we republished this criteria article to make nonmaterial changes to the contact information. On Feb. 26, 2021, we republished this criteria article to make nonmaterial changes to the "Related Criteria" section. RELATED CRITERIA AND RESEARCH Related Criteria Insurers Rating Methodology, July 1, 2019 Principles Of Credit Ratings, Feb. 16, 2011 Refined Methodology And Assumptions For Analyzing Insurer Capital Adequacy Using The Risk-Based Insurance Capital Model, June 7, 2010 These criteria represent the specific application of fundamental principles that define credit risk and ratings opinions. Their use is determined by issuer- or issue-specific attributes as well as Standard & Poor's Ratings Services' assessment of the credit and, if applicable, structural risks for a given issuer or issue rating. Methodology and assumptions may change from time to time as a result of market and economic conditions, issuer- or issue-specific factors, or new empirical evidence that would affect our credit judgment.