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TRADE YOUR RISKS WITH GROWTH BY USING CREDIT INSURANCE

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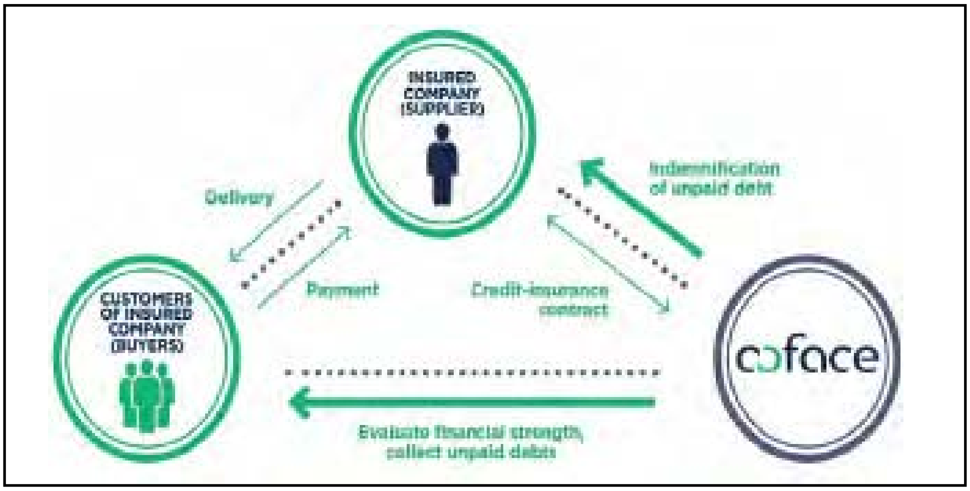
Each and every corporate in its life span must have experienced the stress upon its buyer/s defaulting on its payments obligation, be it exports or domestic. The pain is much severe when the defaulted buyer is consuming a high percentage of total outstanding exposure of the corporate.

There is a solution to this unforeseen and high impact event which shields the corporate from a loss upon default by the buyer due to any financial reasons.

What is credit insurance

It is a risk management tool that provides the companies with protection against failure of its customers to pay their debts.(Insurance of Receivables)



Trade credit insurance can include a component of political risk insurance which is offered by the same insurers to insure the risk of non-payment by foreign buyers due to currency issues, political unrest, expropriation etc. Trade credit insurance usually covers a portfolio of buyers and pays an agreed percentage of an invoice or receivable that remains unpaid as a result of protracted default, insolvency or bankruptcy.

Why to Buy Credit Insurance

Before actually deciding to go for the options available, it is advisable to identify clearly "why" the need of credit insurance and how it will benefit the company.

Risk of unexpected default persists even with customers believed to be "as strong as a Bank". Credit insurance is a great tool to remove this probable uncertain hit and cap company's unsecured exposure by mitigating it.

It is not uncommon for customers to request more credit – either by way of increased exposure or longer payment terms - than one is comfortable giving them, or to have new customers you aren't familiar with or venture into an unchartered territory having no sound knowledge about the political environment(likes of South Africa and Venezuela).

Unfortunately, payment history is not a valid predictor of default. Credit insurance is means to offer competitive open credit terms without taking incremental risk. It supports additional sales that would not have been made otherwise to safely expand global reach of an organisation or to push domestic sales.

Structuring the Program

Policy premium is a generally considered as primary and logical parameter to examine. The final premium that the insurer charges will be priced based on a number of factors including: insurable turnover, industry performance, past bad debts, customer quality, and risk participation levels in the policy.

Risk participation or retention assures insurance companies that the insured has a vested interest in continuing to manage its exposure in prudent manner, while also allowing to minimize the premium payable. Deductible generally will be either in form of each and every loss or aggregate loss, which needs to be accounted for before claim payments start.

One broad rule while arriving at structuring the policy, excessive use of deductible certainly can reduce the premium outflow but can reduce the policy benefit at the time of claims. Start the credit insurance policy with covering what is maximum possible to actually understand the policy parameters and can tweak the structure on the renewal.

The Application Process

Care should be taken in terms of what information, which has to be technically correct, is being provided in the proposal form, which is most important aspect of credit insurance policy. The policy will be quoted based on the information submitted in the proposal form, and this will become part of the contract as an underlying representation in the agreement between insured and the insurer.

Evaluating Offers

In India insurance co issuing credit insurance policy are generally backed by global reinsurers, who do not have licenses to directly issue the policy due to IRDA regulations. Each Reinsurer has its own risk appetites, underwriting philosophies and contract wordings which are carried forward by the insurance co. while issuing the policy to insured. While the coverage is fundamentally similar, Reinsurer widely differs in how they structure and administrate their policies. One should take time to understand how each of them differs on key parameters where the policy needs to be customized taking into account - special terms of sale, industry practise, seasonality, etc..

From a perspective as a buyer of CI policy, it is imperative to evaluate the Reinsurer's and their offers based on the following categories-

- its reputation in settlement of claims,
- contract wording,
- policy terms and
- proposed coverage
- average acceptance ratio on the buyer limits requests

Among other things it is important to understand what are the claim filing deadlines and obligations or reporting requirements of the program which is different for each Reinsurer and extremely critical. Not to mention the claims and recovery processes of each insurance co. are different.

Comparing premiums and deductibles and/or coinsurance has to be done in light of what the carriers are offering on coverage limits and policy conditions. Credit insurance is not a commodity product that can be shopped on price alone. The goal is to find the program that best matches the needs on how the policy should work under the given business constraints and yet provide the necessary coverage.

Implementing and Managing the Program

On an ongoing basis one should monitor buyer exposures in the event where there is a need to add new accounts or increase the coverage limits on existing buyers. Also current overdue position of receivables should be monitored to check whether they need to be reported or extension on reporting to be sought. As a healthy practise it is advisable to maintain a summary of the obligations and the key policy requirements like claim filing time frames or overdue reporting and periodical declarations.

Credit insurance is a incredible financial and risk management tool. With the right partner, insured can enjoy protection on one of company's largest assets, safely expand sales, improve borrowing arrangements and take advantage of expert credit guidance.

Recent IRDA guidelines allows the banks to take the assignment of the policy as loss payee for getting the proceeds of claims from the insurance co. Banks have also accepted TCI policy as security and reduced the collaterals attached to the working capital programs or reduced the lending rates due to strong risk mitigation tool attached to the debtors.

Credit management offers business a competitive advantage in today's global uncertain times. It is much more than just an off the shelf product and can do wonders if used in correct manner. Corporates that recognise the potential will be the ones that will win in long run. MA

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