

33rd India Fellowship Webinar

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Case Study 1 - Trade Credit Insurance

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Agenda

- Case Study - Background
- Trade Credit Insurance Overview
- Credit Insurance Landscape in India
- Impact of COVID- 19
- Reserving Aspects
- Pricing Aspects
- Summary



Case Study - Background

Case Study: Trade
Credit Insurance

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- The IRDAI working group on revisiting Guidelines on Trade credit insurance has recently released its report.
- In the current scenario when global economy has been impacted by Covid-19, trade credit insurance has become an important risk management tool for all suppliers.



Trade Credit Insurance



Coverage of losses due to debtor's inability to pay because of going into liquidation or ceasing to exist or to trade.

Why do companies need Trade Credit Insurance?



- Money owed to a business is one of the largest items on the balance sheet
- Business suffers a loss if money owed is not paid
- This potential loss can be insured through credit insurance policy

Key Customer for Trade Credit Insurance

Case Study: Trade Credit Insurance

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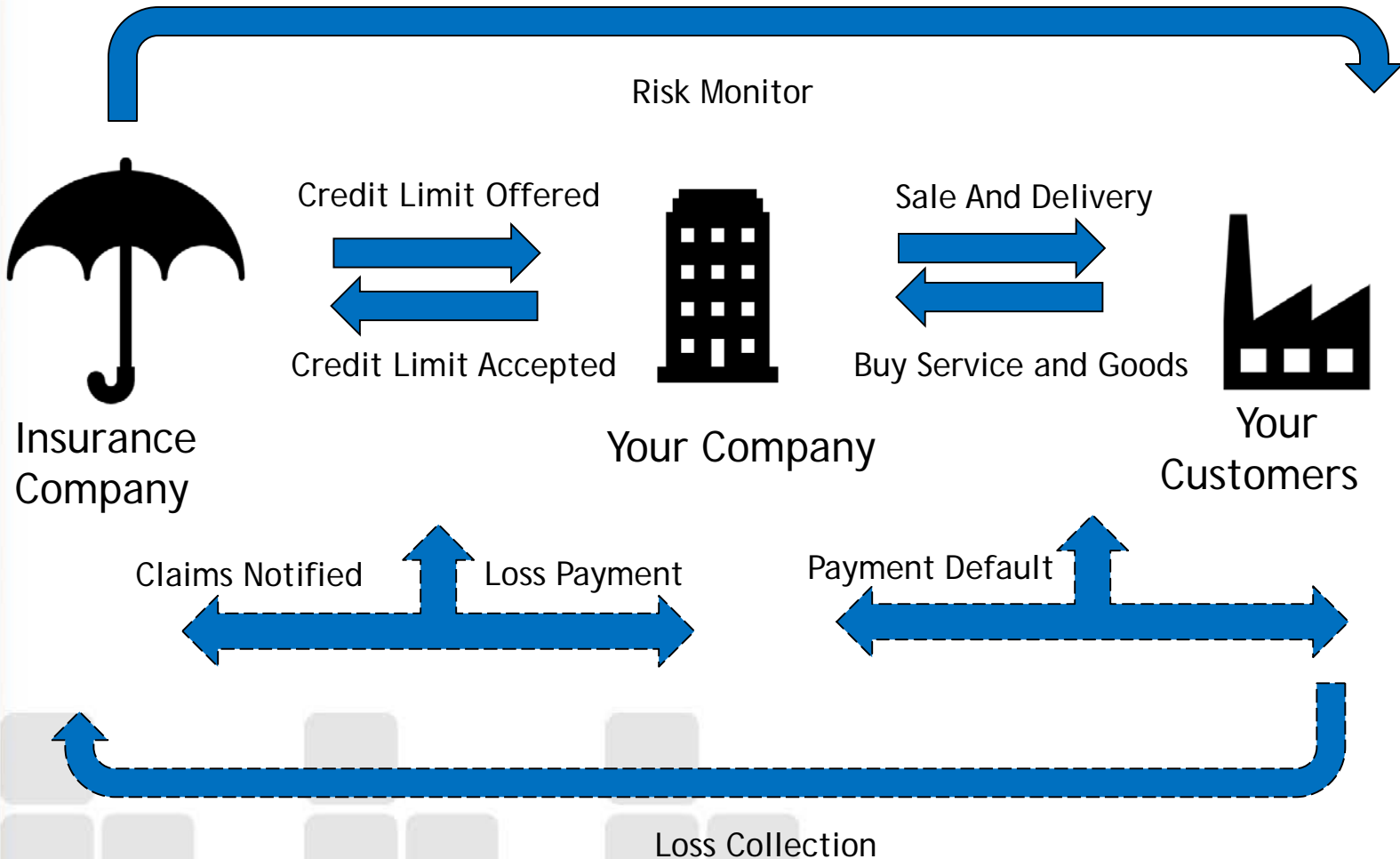
Domestic Suppliers

Local Suppliers who provide trade credit to its customers

Exporters

Any company that exports to countries where there is challenging political environment to conduct its business

Trade Credit Insurance - Mechanism



Trade Credit Insurance - Types of policies

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Whole Turnover Policy

Insuring whole of the turnover against the risk of debtors defaulting.

Specific Account Policy

Insuring a selective account that is assumed to be at risk. Premiums are higher for this type of policy due to potential selection against the insurers.

Trade Credit Insurance

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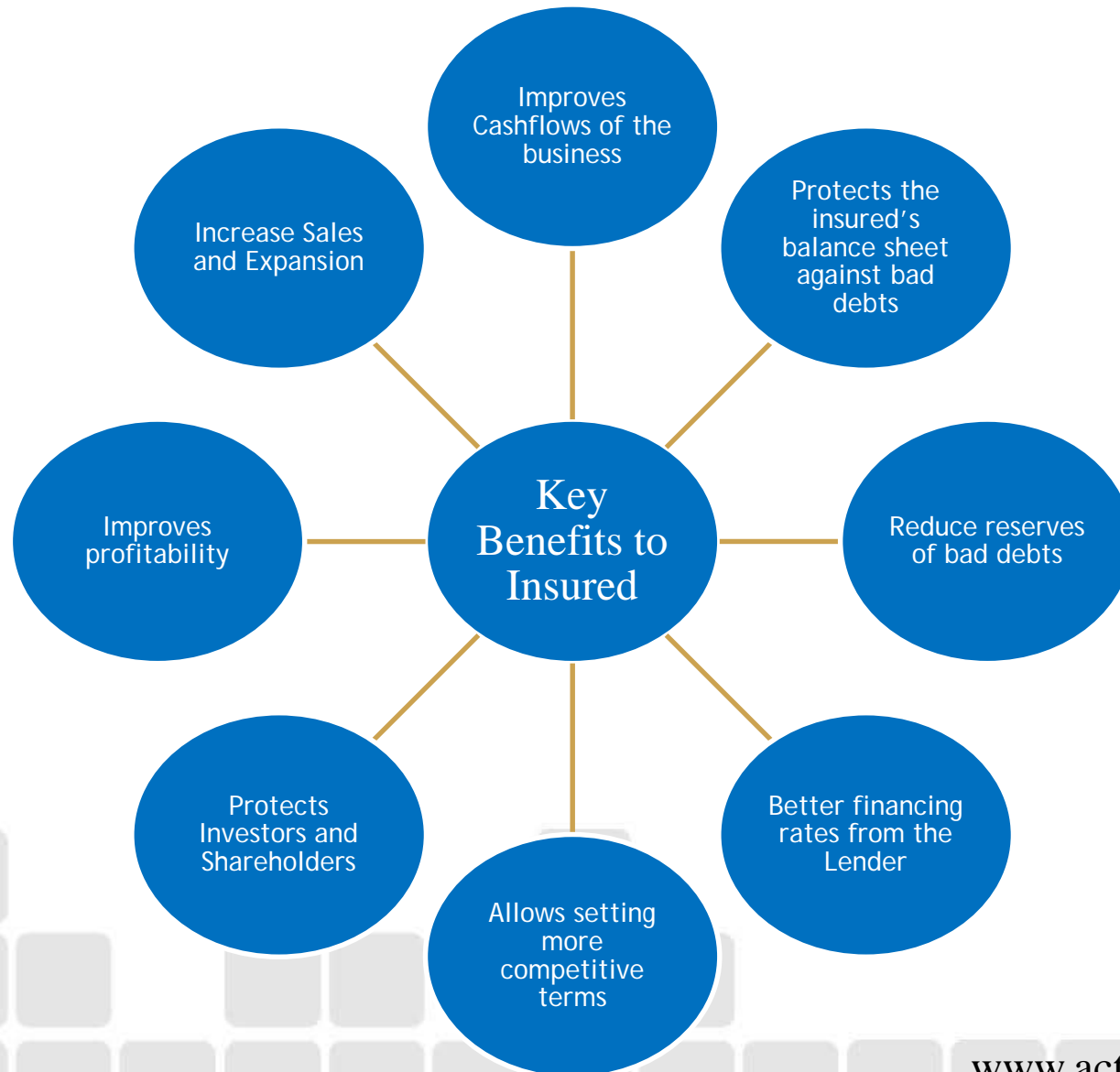
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What is Covered?

Defaults

- If debtors fails to pay receivables within a pre-defined period.

Insolvency

- Non-payment if buyers becomes insolvent

Political Risk

- For exporters, the policy also covers some of the additional risk related to non-payment due to:
 - Moratorium

What is Covered?

Political Risk

- Transfer Restrictions
- War, Riot
- Import / Export Restrictions
- Natural Disaster
- Cancellation of Import License

Optional Coverage



- Pre-Delivery work in progress : This covers the materials and labour cost incurred if work is carried out towards a contract but because the customer goes into liquidation, the work is never finished and invoiced.



Exclusions



-  Trade disputes
-  Currency Changeability Risk
-  Bills Discounting
-  Pre-Shipping risk
-  Buyers under direct or indirect control
-  Failure to comply with material laws in connection with the insured goods

-  Sales to a private individual who intends to use the goods or service for non-professional purposes
-  Sales under irrevocable and confirmed letter of credit

Alternative to Trade Credit Insurance



- Self Insuring
 - Not the most capital efficient way
- Factoring
 - Popular alternative to Trade Credit Insurance
 - Refers to selling your account receivables at a discount :
 - For example, if you are expected to collect Rs. 1,000 in 2 months, you can sell your account receivable for Rs 950.
 - Provides you immediate cash and hence remove the default risk
 - More costlier than Insurance Policy
- Letters of Credit
 - A commitment by a bank to guarantee the payment provided all terms and conditions are met

History - Trade Credit in India

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1957

- Setup of ECGC for Export Trade Credit Guarantee

1999

- Formation of IRDA after opening of insurance sector

2001

- First trade credit insurance product approved and launched

2010

- First set of guidelines released

2016

- Relief provided on guidelines set in 2010

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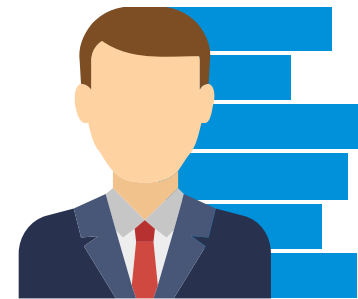
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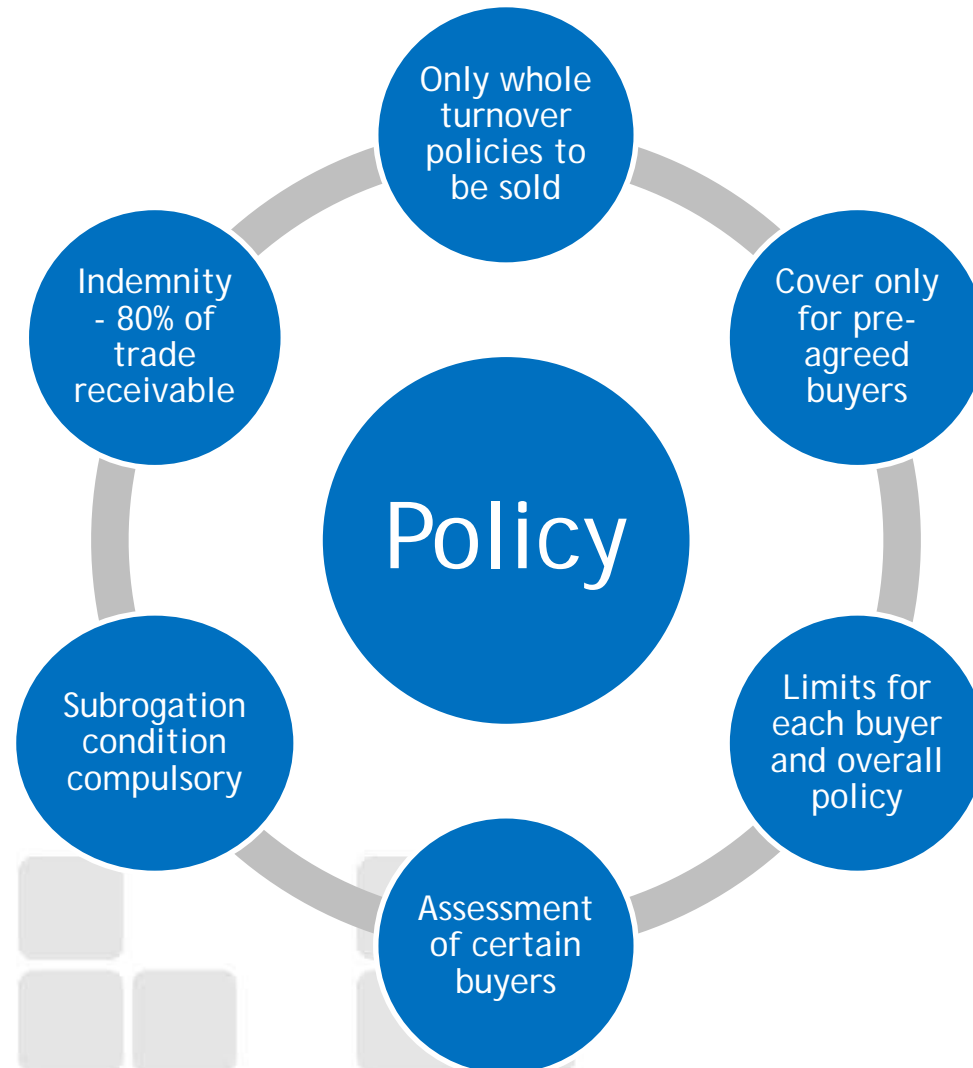
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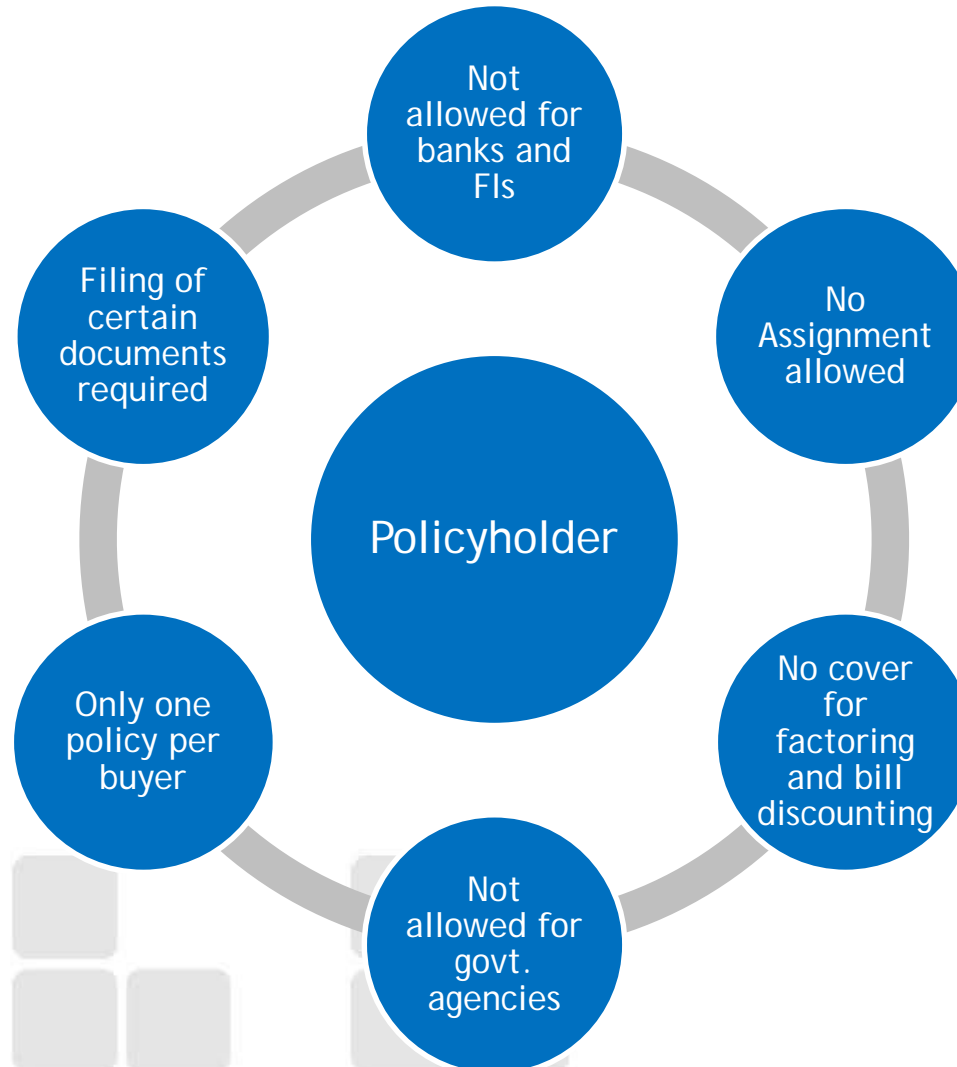
Credit Insurance Landscape in India



Initial Guidelines (2010)



Initial Guidelines (2010)



Revised Guidelines (2016)

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- Assignment of claim proceeds was permitted
- Flexibility in whole turnover in terms of Segment/Territory was permitted
- Indemnity was increased to 85% of trade receivables
- Cap on minimum of 10 buyers per policy was lifted

Current Market Scenario

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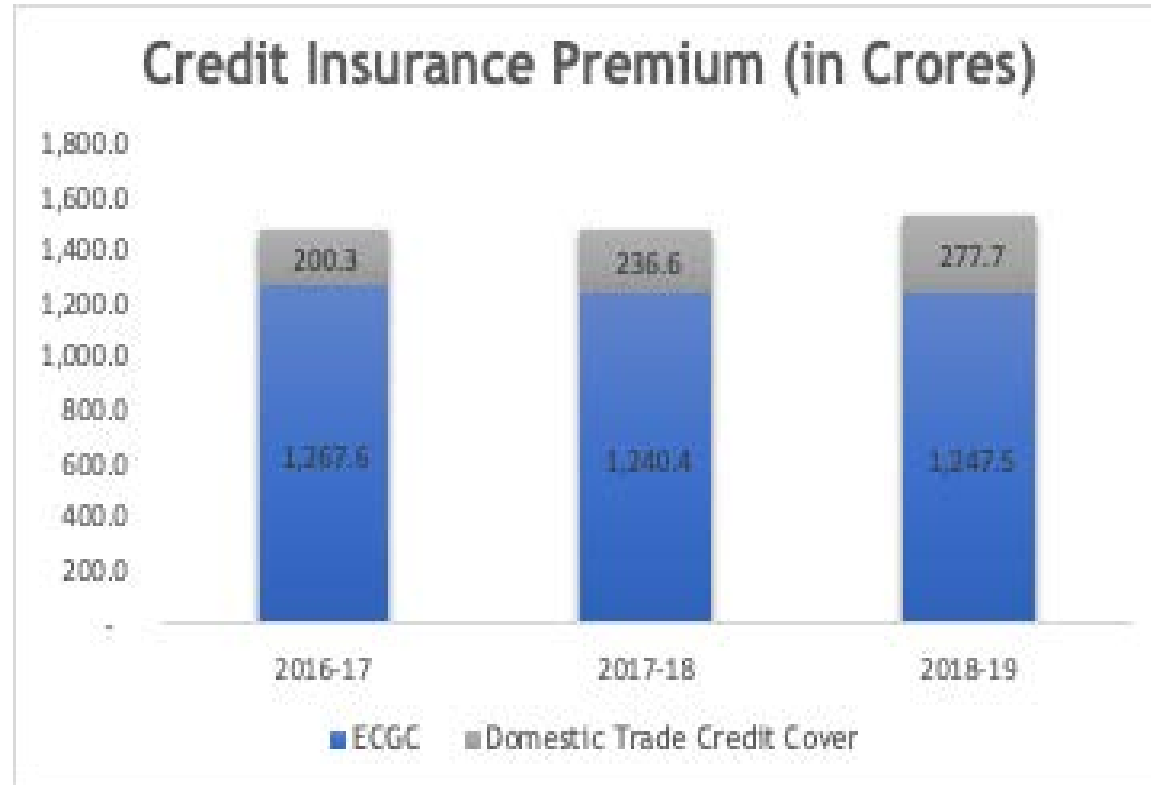
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Information taken from Report of IRDAI Working Group on revisiting guidelines on Trade Credit Insurance

Current Market Scenario

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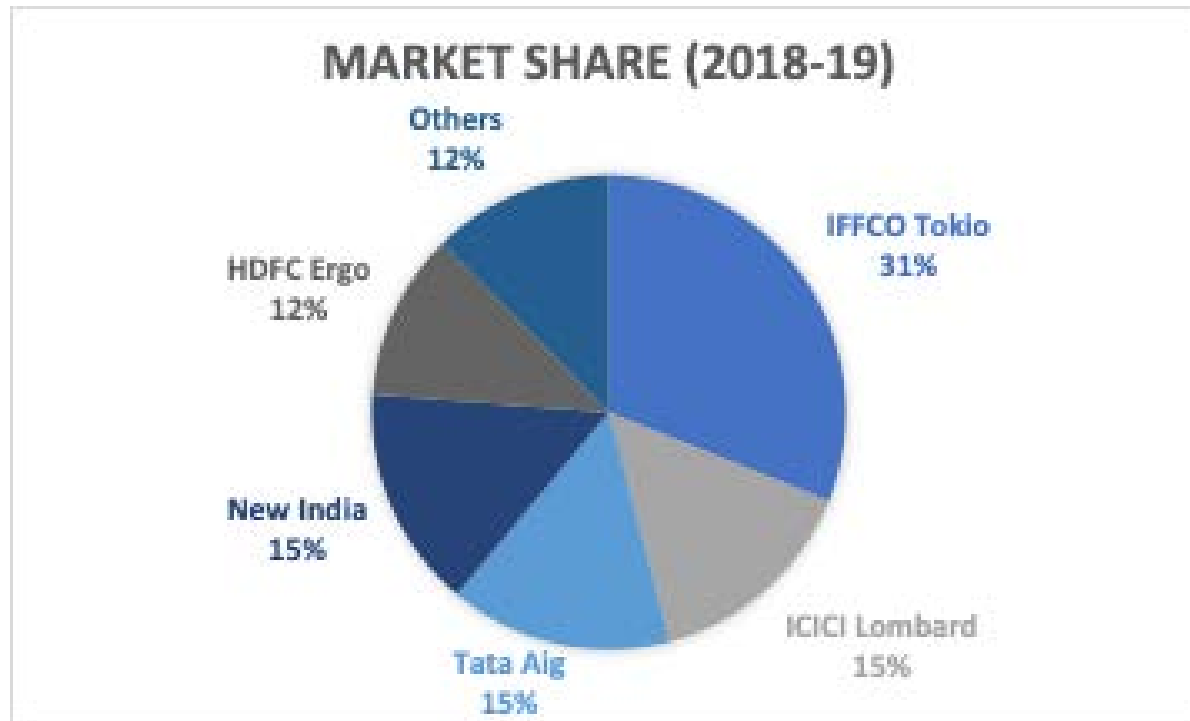
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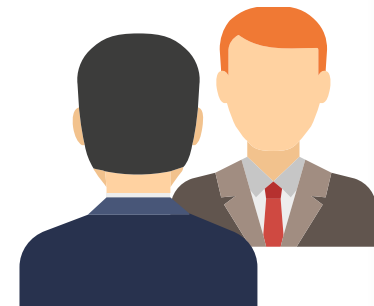
Summary



Information taken from Report of IRDAI Working Group on revisiting guidelines on Trade Credit Insurance

IRDAI Working Group

- Created vide IRDAI order on 29th August 2019
- Re-visit guidelines on Trade Credit Insurance
- Report of the working group released on 11th May 2020
- Covered the following aspects
 - Understanding Credit Insurance
 - Analysis of Credit Insurance Market in India & Worldwide
 - Credit Insurance for Banks & Factoring Business
 - Micro, Small & Medium Enterprises (MSMEs)
 - Online Trading Electronic Platforms such as TReDS



Weaknesses & Remedies

Weakness	Remedy	Reasons
Cover offered only on goods and services	Offer cover on any transaction	Potential to sell insurance to banks / FIs and factors
Sold only on whole turnover basis	Allow policies covering individual buyers also	Attractive for MSMEs
Indemnity at 85%	Indemnity at 90%	Align with global standards
Indemnity at 85%	Indemnity at 95% for political risks for MSMEs	Relief for losses beyond MSME's control
Appointment of credit management agency	Allow credit management services in-house or with a re-insurer	To leverage technical support that might be readily available

Looking Ahead

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Creation of Buyer
Default Database
with IIB

Access of CIBIL
database or
similar platforms
for underwriting
processes

Recognition of
Credit Insurance
as risk mitigation

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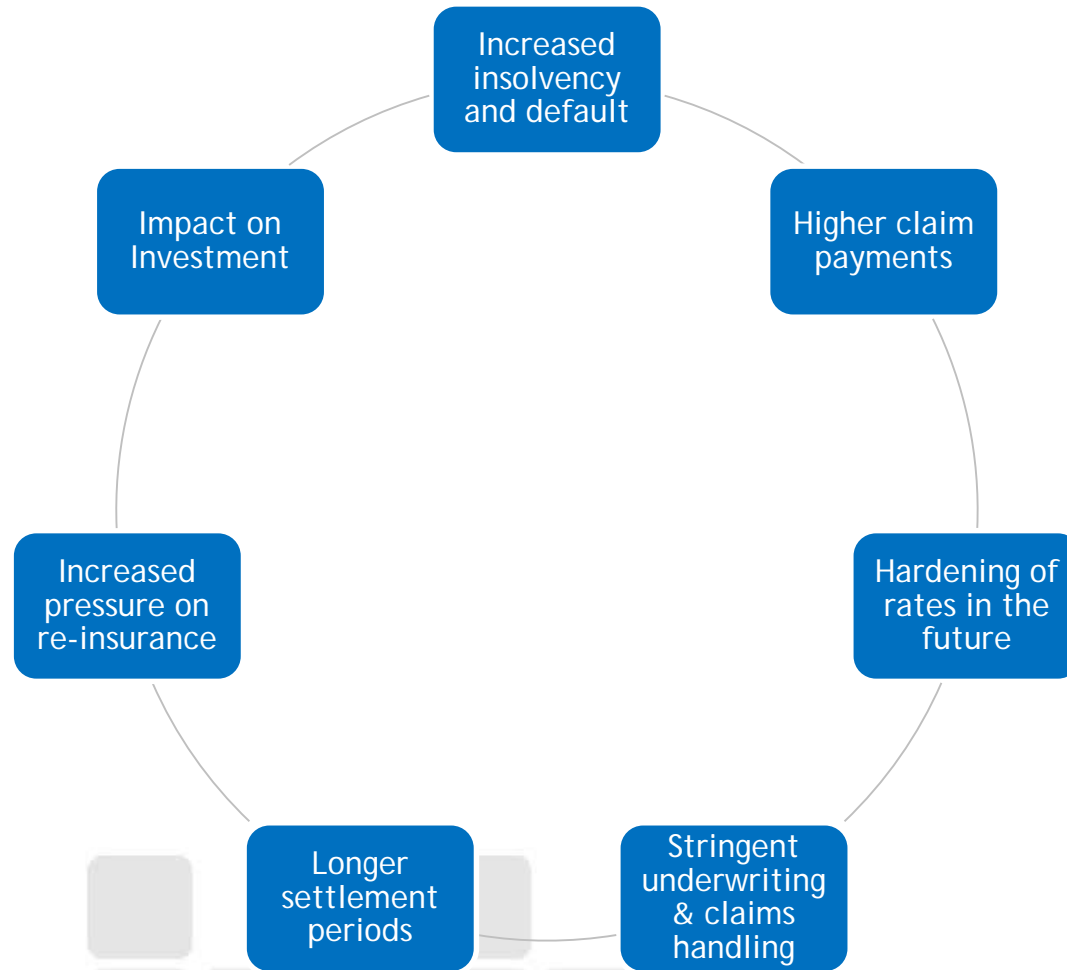
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Reserving Aspects



Reserving Considerations

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Loss Reserves are largest element of an insurer's balance sheet

IRDAI requires insurer's to hold following Technical Reserves-

- Case Estimates
- IBNR and IBNER Reserves
- Unearned Premium Reserve
- Unexpired Risk Reserve

Triangulated Data

- Most recent and reliable
- Incurred and/or Paid Triangles



Methods

Typical methods may be used:

- Chain Ladder Techniques
- Bornhuetter-Ferguson Method
- Ultimate Loss Ratio Method
- Average cost per claim Method

Regularly monitor

- Diagnostics
- Actual vs expected analysis

Use of Exposure based methods



Assumptions

- Averaging period
- Tail
- Initial Expected Loss Ratios (IELRs)
- Method

Judgement



Key Judgements

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Some of the factors that must be allowed or adjusted for :

- Economic Uncertainty
- Political Risks
- Changes in underlying mix of business
- Business Cycle
- Accumulation of losses
 - Single event
 - Individual purchaser
 - Economic downturns
- Atypical or unusual large losses
- Inflation



How are these allowed / adjusted for?

Development to Ultimate

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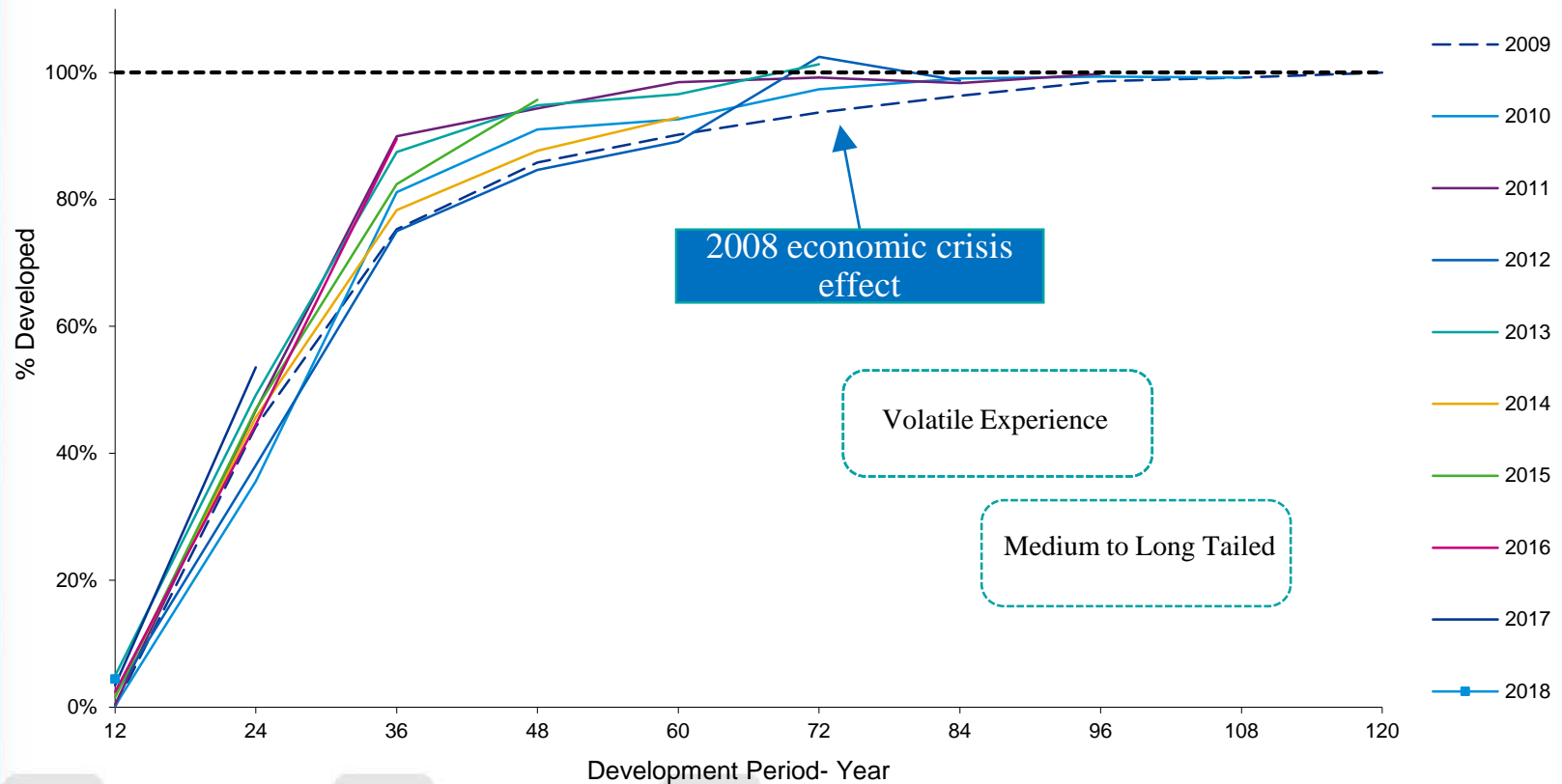
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Scor- Credit and Surety line- chart to illustrate incurred development to ultimate



Source: Scor Global Triangles; Credit & Surety Reinsurance
Underwriting Year Basis

<https://www.scor.com/en/file/34872/download?token=27yqHfZr>

Loss Ratio Experience

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AXIS Capital Holdings Limited 2018 Loss Development Triangles Values in Thousands USD

Insurance Credit and Political Risk

ITD Summary

Gross									
Accident Year	Written Premium	Earned Premium	Paid Losses	Case Reserves	Case Incurred Losses	IBNR	Ultimate Losses	Ultimate	Loss Ratio
2008 and prior	1,019,999	494,567	49,215	(1,694)	47,521	220	47,740		9.7 %
2009	19,450	188,311	342,106	(3,737)	338,368	3,598	341,967		181.6 %
2010	30,669	89,773	102,821	(4,415)	98,406	1,270	99,676		111.0 %
2011	35,734	97,680	27,695	—	27,695	272	27,967		28.6 %
2012	39,405	87,102	53	—	53	157	210		0.2 %
2013	60,203	69,482	13,854	(5,520)	8,334	5,813	14,147		20.4 %
2014	45,368	64,381	57,918	10,595	68,513	1,237	69,750		108.3 %
2015	59,967	65,387	23,328	—	23,328	2,707	26,035		39.8 %
2016	49,930	62,744	24,831	—	24,831	18,105	42,936		68.4 %
2017	91,316	71,333	7,585	484	8,069	20,588	28,657		40.2 %
2018	190,433	139,043	5,838	(476)	5,362	52,672	58,034		41.7 %
	1,642,474	1,429,803	655,244	(4,763)	650,480	106,639	757,119		53.0 %

Source: <https://investor.axiscapital.com/file/4080716/Index?KeyFile=1500121438> (pg 36)

Reinsurance & Recoveries

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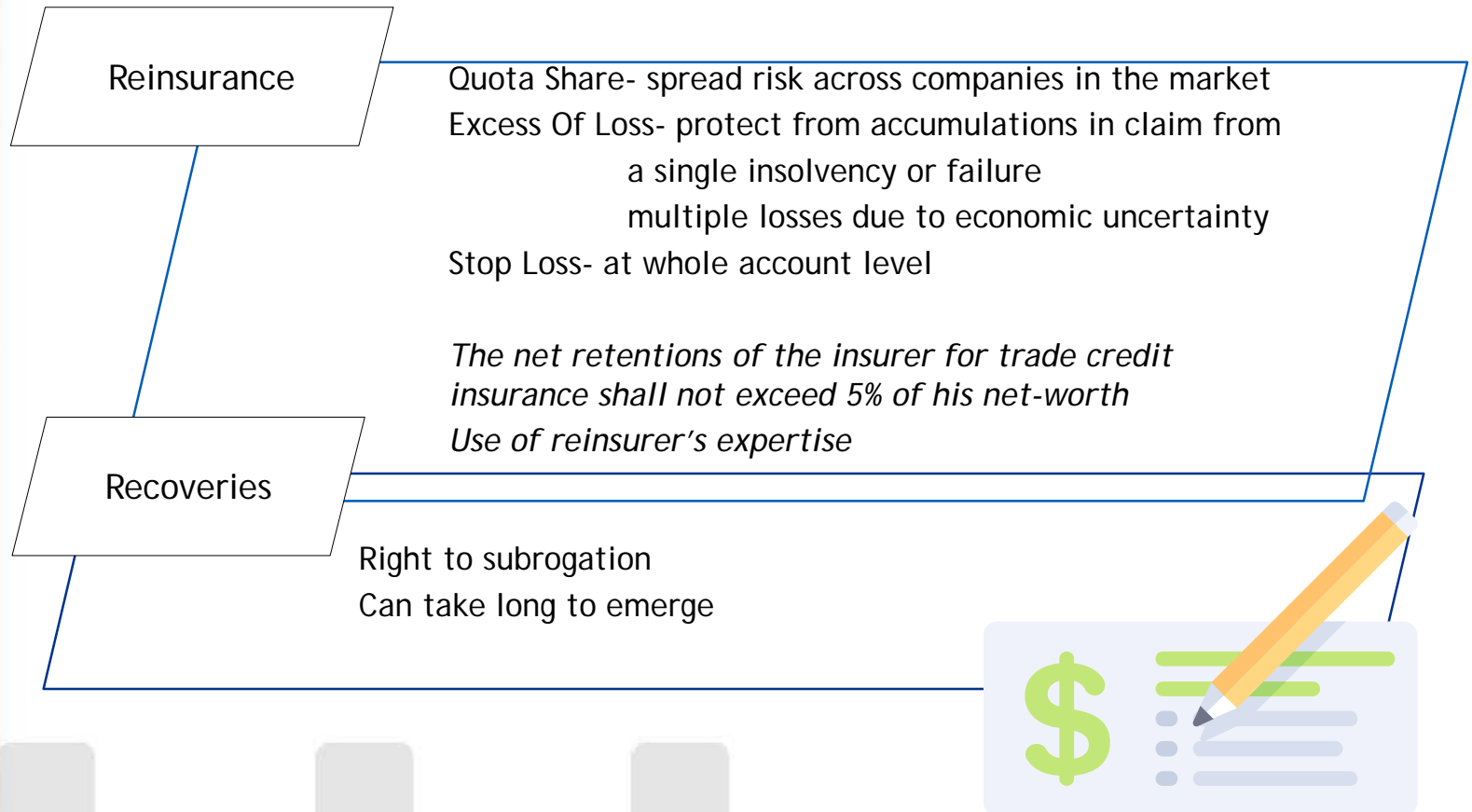
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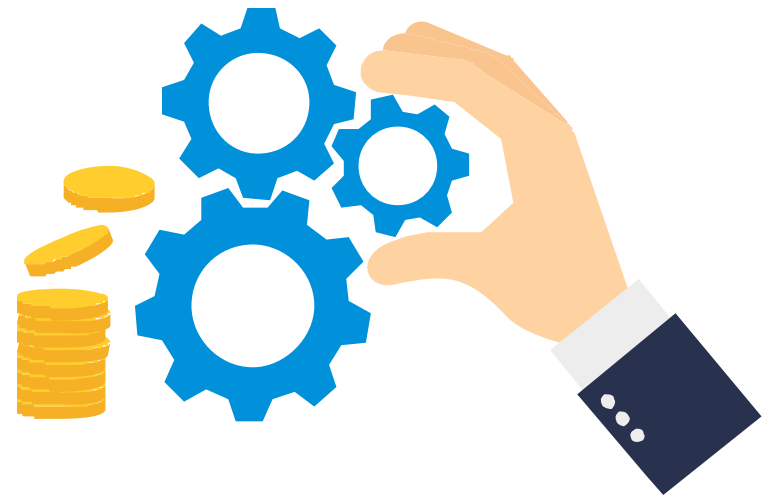
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IRDAI Guidelines- Underwriting

In 2016, IRDAI issued guidelines on trade credit Insurance¹

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Underwriting factors:

- Trade Sector/ Industry
- Debtors Turnover
- Level of Insurable Turnover
- Credit Rating and Bad Debt History
- Internal Credit Management
- Quality of Buyer Base and spread of risk



Policy Limits

- Percentage Insured (Limits of Indemnity)
- Maximum Liability Amount
- Deductible



Buyers

- Credit Limit
- Granted Credit Limit



Buyer Risk Management

Use of Credit Management Agencies

1. CIRCULAR NO.IRDAI/NL/CIR/CRE/044/03/2016, DATED 10-3-2016

Actuarial Pricing

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The premium rate

- reflects the average credit risk rating of the insured portfolio of buyers
- expressed in terms of net debt or value of receipt or shipment/ goods declared

Premium structure must reflect average economic conditions over the risk period



Actuarial Pricing

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At a very high level, insurer's premium should cover following:

Premium =

Risk Premium (Expected Losses with allowance for cat/
large losses)

Loadings

- Reinsurance costs &
- Allowance for reinsurers credit rating
- Underwriting Expenses
- Other Expenses
- Profit
- Other Considerations

Investment income credit



Other Considerations

- Forecast of economic climate
- Policy & Credit Period Conditions
- Competition
- Insurance Cycle
- Regulations

Renewal- Combination with Experience Rating

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- Trade Credit Insurance is a business-to-business type of policy and covers debtor's inability to pay.
- First set up in 1957 as ECGC. In 2001, first trade credit insurance product was approved and launched.
- In 2019, working party group provided recommendations for 2016 guidelines.
- Increased uncertainty from COVID 19 affecting claims, investments, etc.
- The actuary approaching this line of business needs to understand the nature of the business and its special features.
- Traditional methods of projection require adjustments and considerations for economic and business cycles.
- Pricing for this line requires more judgement than some other lines.



Questions



Thank you

