

SECTION 8

EVALUATION AND CONTROL OF BUYER RISKS **AND RISKS ON BANKS**

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CHAPTER I

EVALUATION AND CONTROL OF BUYER RISK

Introduction

Although the process of policy underwriting results in the issue of a contract of insurance providing the policyholders with an overall maximum liability, the policyholder does not begin to be protected and the insurer is not effectively on risk until a valid credit limit is issued.

Buyer underwriting is a process which involves:

- (a) an assessment of the integrity and credit worthiness of overseas buyers, including the marketability of their imports and their own marketing ability, and the risks involved in covering the exports to them.
- (b) a determination of the basic terms and limits within which the policyholder may prudently export to the buyer.

Characteristics of Credit Limit

A credit limit is the maximum amount of loss the insurer may be liable for in respect of each buyer. It is generally revolving, applicable for a credit period not more than 180 days. It can be varied or cancelled at any time based on the strength of information on the buyer and the policyholder and can be restricted by imposing additional conditions. The approved payment term applies automatically to less risky terms.

Underwriting Criteria

In determining a credit limit, the following underwriting criteria should be considered:

- (a) the country and the product
- (b) financial strength of the buyer
- (c) qualitative assessment of the buyer
- (d) policyholder's performance
- (e) underwriting experience

Additional Criteria on Public Sector Buyer

- a) Status in Government Structure (Dept./Public Company/Statutory Body)
- b) Source of Paying Funds (Central Treasury, State Authority, Autonomous etc.)
- c) Is Solvency Action Possible?
- d) Is Recovery of Debt a Practical Proposition?

a) The Country and the Product

The assessment of country involves a detailed study of a country's political system, stability of its government, and its relations with other countries. It is equally important to look at a country's GDP growth, inflation, economic management, balance of payments and its international reserves.

Country risks are distinct from buyer risks, but a country's economic condition has implications on an individual firm's performances. Very often, the number of business failures starts to increase when the economy begins its downturn.

The examination of products in buyer underwriting is concerned with how well the product might sell in the buyer's market. This involves a judgment of the likely obsolescence of the product, the buyer's experience to sell the products, the marketability of the product, and the implication of the brand name and pricing of the product, etc.

b) Financial Strength of the Buyer

A buyer is creditworthy if he has the ability and the willingness to buy, sell and pay in accordance with the agreed payment terms.

In assessing a buyer's ability to pay, the underwriter should try to analyse the buyer's financial condition, his sales and profitability over a period of time, his cashflow and his ability to service debt.

c) Qualitative Assessment of the Buyer

There are quite a number of cases where the buyer is capable of paying the policyholders but comes up with various excuses to avoid payment. The integrity and willingness of the buyer to pay is as important as his paying ability.

In assessing a buyer's willingness to pay the underwriter should look at the buyer's background and his management, the company's payment record and reputation, and the consolidated performance of the whole group.

(d) Policyholder's Performance

Due consideration should be given to the performance of the policyholder under the policy and his need for the full extent of the credit limit. If the policyholder has already proved to be something of a problem, an austere view would be justified. If the policyholder has effective credit control, satisfactory policy performance and good trading experience, favourable consideration can be given.

(e) Underwriting Experience

The aggregate credit commitments and payment experience in respect of the buyer and the buyer's group should be taken into account. The extent to which other credit limits have been used should be examined, and those under-utilized should be clawed back.

Determination of Credit Limit Amount and Terms

The determination of the size of a credit limit requires a decision that the buyer is creditworthy for a certain overall amount after consideration of the criteria mentioned. For shipments made by air or shipments seeking DP terms with a long credit period, open account terms should be offered.

(a) The Appropriate Name and Address of the Buyer

Attention should be paid to the name and address of the buyer as applied and whether it is different from that reported by the credit agency. Different names of a buyer represent different legal entities. An approved CL on a buyer does not apply to the other group members of the buyer.

b) Specific Conditions

When justified, a credit limit condition can be imposed to restrict the use of such limit, e.g. a condition specifying an expiry date, a condition specifying that the credit limit may be used for a specific transaction or group of transactions. However, conditions should only be imposed sparingly.

Discretionary Credit Limit and Automatic Credit Limit Approval

A discretionary limit is a small limit on each buyer extended to a policyholder automatically for cases where the policyholder has not submitted an application. However, the policyholder must obtain a bank or credit agency report on the buyer beforehand and such a report should not indicate any adverse information with respect to the creditworthiness of the buyer.

To improve the response time for small credit limit applications, it is worthwhile to consider approving small credit limits automatically through the computer before obtaining the usual bank or credit agency reports.

Certain exclusions have to be set and the size of the amount should be set at a level to contain the likely occurrence of small claims to an acceptable amount.

Buyer Underwriting Philosophy

All-in-all, buyer underwriting is an operation which combines the disciplines of a science and the subjectivity of an art. To enhance customer satisfaction, it is important to adopt a more pro-active and aggressive approach in handling credit limit applications without losing the quality of underwriting at the same time.