SECTION 2

TRADE AND INVESTMENT INSURANCE IN A GLOBAL CONTEXT

CHAPTER 1

THE GLOBAL SCENE

INTERNATIONAL PERSPECTIVE

(a) ORIGINS AND DEVELOPMENTS

Credit insurance, as it is known and recognised today, had its origins in the insurance of domestic credit risks in a number of European countries, especially France, Germany and Switzerland, commencing in the middle of the last century. In Britain, in the latter part of the 19th Century, British merchants shipping goods to Australia created one of the first recorded demands for export credit insurance. After the First World War, the perceived need of many European countries to protect and expand their external reserves and to stimulate employment through the promotion of export activity, added a new dimension to the conception of export credit insurance. This was clearly illustrated in 1919 when the British Government launched the original official export credit scheme with the object of encouraging exports to Eastern Europe where credit risks were considered to be a serious deterrent to the development of British exports.

From that time to the present day, a steadily increasing number of countries in both the developed and developing world have seen in the establishment and development of an export credit insurance scheme an important tool for promoting their export trade, increasing employment opportunities and improving the credit side of their balance of payments. At the same time, the growing incidence of risk in international trading arising from political unrest, trade embargoes and the restrictions imposed by importing countries in balance of payments difficulties on the transfer of foreign exchange required to make payment to foreign suppliers, has boosted the demand from exporters and their financiers for the protection of credit insurance.

(b) THE BERNE UNION AND RECENT DEVELOPMENTS

As long ago as 1934 the emergent practitioners of export credit insurance realised the wisdom and value of co-operating in the development of underwriting techniques and in exchanging information on payment experience and other matters of mutual interest. In that year the export credit insurers in France, Italy, Spain and the United Kingdom founded the Union whose full title today is the International Union of Credit and Investment Insurers.

Since the 1939/45 War, insurance against political and commercial risks in international trade has assumed steadily increasing importance. Both state controlled organisations and private insurance companies constitute the membership of the Union, all participating as insurers and not as representatives of their governments.

The Statutes of the Union provide that its purpose shall be to work for:-

(i) the **international acceptance** of sound principles of export credit insurance and the establishment and maintenance of discipline in the terms of credit for international trade;

(ii) international co-operation in encouraging a favourable investment climate and in developing and maintaining sound principles of foreign investment insurance; and

(iii) to provide for the exchange of information, assistance, expertise and advice in relation both to the commercial and political risks involved in export credit insurance, to the political risks involved in foreign investment insurance and to the range of associated matters relating thereto.

The break up of the Comecon trading bloc has presented a major challenge to the exporters of all the member countries of that group since they now have to compete for business in the international market place.

The responsibility of the management of individual enterprises for the assessment of the creditworthiness of individual countries and individual customers and the need to go to the emerging private market to obtain finance for export activities are new concepts which had to be absorbed and developed once the Berlin Wall came tumbling down. This caused governments to explore and recognise the need for export credit institutions and now only Bulgaria of the old Eastern Bloc countries is without an officially supported export credit institution. Moreover, in the countries of the former Soviet Union there are also developments in this field -in Russia itself and in some of the newly independent States such as Kazakhstan and Uzbekistan.

In other parts of the world, export credit schemes have been.. or are in the process of being, set up in such diverse places as Botswana, Colombia, Chile arid Trindad.

2. THE ROLE OF GOVERNMENTS

Export credit insurance is provided or supported by Governments because they want to encourage national exports. Government intervention has been considered necessary since it is generally believed that the risks, especially the political ones, are too large and unpredictable to be borne by private insurers who need to make a profit to live.

There is no fundamental reason why export credit insurance should not be provided by private sector insurers, at least as far as the commercial risks noted above are concerned. Their evaluation calls for judgements similar to those made by banks and other providers of credit in the ordinary course of their businesses; there are many private sector companies who provide credit insurance against the commercial risk to both domestic traders and exporters. There is, however, much less involvement by the private sector in the insurance of the political risks and such. insurance is often only available directly or indirectly from governments interested in furthering their national interest by encouraging exports. Large and unusual commercial risks may also be insurable only with governmental insurers or reinsurers.

In the countries of the European Economic Community it has been determined that Government support in the export credit insurance field should not be applied to business which can be insured or re-insured by the private sector. This lead to the British Government selling the U.K. insurers (E.C.G.D.) short-term business to the Dutch insurer, N.C.M. E.C.G.D. remains as a Government insurer confined to medium and long-term business. In recent years the private insurance market has shown an increasing willingness to become involved with export credit business, including some greater involvement in political risks. However, outside Europe Governments are still by far the major players in this field.

3. INSTITUIONAL STRUCTURES

The involvement of Governments in the structure and management varies widely from country to country. The main categories are:

(a) Government departments: ECIS in Cyprus, EID/MITI in Japan, ECGD in U.K.

(b) State bodies or government agencies: OND in Belgium, SACE in Italy, BANCOMEXT in Mexico, EXIMBANK in U.S.A.

(c) 100% government owned corporations: EFIC in Australia, EDC in Canada, HKEC in Hong Kong, ECGC in India.

(d) 100% privately owned companies:

  (i) operating as agents of government: OEKB in Austria, HERMES in Germany.
  (ii) with partial reinsurance from government: CASC in Argentina, NCM in Holland, CGIC in S. Africa, ZCIC in Zimbabwe.
  (iii) with no official link with government but with reinsurance agreements with national ECA's: SIAC in Italy.
  (iv) purely private: T.I.C. in U.K., FEDERAL in Switzerland, EXGO in New Zealand.

CONTROL AND DECISION MAKING PROCEDURE

Most ECA's have Boards of Directors but their composition varies very much from one agency to the other: representation of shareholders, mixture of private and public bodies, representation of various public bodies and of regions, exporters and export associations and financial institutions, especially Banks, etc.

The role of the Board, its involvement in the daily business, in the setting of guidelines also differs widely from one agency to the other. In some countries the Board has only an advisory function.

Some members also have to report to or receive guidelines from other (guardian) authorities, advisory bodies etc., who usually are an arm of their government or dependent upon it. The impact of these various bodies on the -decision making, again, varies from country to country.

In summary, you are involved in a significant, growing, diverse and challenging aspect of international trade.

4. TRADE INSURANCE

The purpose of export credit agencies (ECAs) is to provide exporters with insurance against the risk of non-payment for. their sales to foreign customers. The provision of such insurance often has the additional benefit of facilitating the generation of export finance from banking sources; some ECAs provide export finance themselves.

(a) THE RISKS

ECA's are concerned with two types of risk:

(i) the commercial (or buyer) risk - the risk that a foreign buyer will fail to meet his payment obligations to his supplier due to default or insolvency, and

(ii) the political (or country) risks, including:

The transfer risk i.e. the risk that a buyer with adequate local funds available to meet his obligations, is unable to obtain the foreign exchange required to meet those obligations;

the risk that previously issued authorities to import and/or pay for goods ordered and/or supplied may be revoked by the relevant authority in the buyer's country;

the risk that the occurrence of war, revolution etc. may prevent the completion of a transaction either so far as the shipment or delivery of goods, or payment for them, is concerned;

the risk that the authorities in the exporter's country may cancel a previously issued export licence or introduce new licensing requirements that frustrate an exporter's contract.

(b) FINANCIAL OBJECTIVES

As with all insurance operations, ECAs charge a premium for their services. Private sector ECAs seek to operate profitably and therefore charge market rates that they consider likely to achieve this aim. Government or government-backed ECAs are required by the provisions of the WTO* not to operate as a subsidy mechanism and generally, seek to at least break even on their operations over time by charging premium rates adequate to cover claims payments and administrative expenses. The imponderability of the political risks is illustrated by the balance of payments problems experienced by many third world and other countries in the 1980's, which gave rise to very large claims payments by the larger ECAs and to the build up of substantial cumulative deficits on their operations in recent years, which have only recently started to be redressed.

Some ECAs have a 'national interest' provision in their constitutions which enable them to refer to government., propositions which do not satisfy their established underwriting criteria but which are of significance, in terms of the national interest of their country. If government accepts such a risk the premiums and the responsibility to pay any claims are for the account of government and not the ECA.

Australia, United Kingdom, Belgium, Sweden and USA are amongst many countries which have some form of national interest provisions. While there are no generally accepted guidelines, the main criteria for giving support under 'national interest' can be summarised as follows:-

importing country risk (off cover for normal business, not judged creditworthy considering the amount of the transaction, uncertainties as to future, etc.)

risks linked to the project (very high value, long term, aid nature of the contract)

home country consideration (goals set for national policy, especially in relation to support for certain industries, matching unconventional credit terms, encouraging the private sector to get into certain developing markets, i.e. pump priming)

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* World Trade Organisation

These criteria are often applied in conjunction with one another.

(c) TYPES OF BUSINESS COVERED

Export credit insurance schemes were originally designed to provide protection for an exporter who entered into a contract of sale with an overseas buyer on credit terms evidenced by a sight draft, bill of exchange, promissory note or some such well established payment instrument. As the provision of credit facilities to oil the wheels of international trade has become both more extensive and increasingly sophisticated, embracing virtually the whole gamut of trading activities in goods and services, export credit insurers have increased the range and scope of their insurance facilities to meet the demand for protection against the various risks of loss.

Consequently most export credit insurers now offer cover against the particular risks arising when services are provided either alone or in tandem with the supply of goods, when constructional works contracts are entered into, when the goods are leased rather than sold or when goods are delivered to stock or sold through the overseas subsidiary of the insured exporter. These are but a few examples of the growing sophistication of export credit insurance facilities.

Moreover, some export credit insurers in countries which are important suppliers of capital equipment, whose sales involve the most extended risks horizons, have introduced various forms of cover in relation to the foreign exchange risk where their exporter is contracting in a currency other than his own. Such cover is usually only applicable from the time the normal forward exchange market facilities are no longer available and/or where the exporter has to quote a firm price in foreign currency and then be exposed to possible currency fluctuations. while the buyer decides whether or not to award the contract to him.

The type of business covered by ECAs can, generally, be divided into two basic categories:

1. short term credit business involving the sale of raw materials, commodities and consumer goods on credit terms of not usually longer than 6 months, and

2. medium and long term credit business involving the sale of capital and quasi capital goods on credit terms up to 5 years or more, depending upon the nature of the equipment to be supplied and the value of the contract. Contracts for the supply of complete projects may attract longer credit terms up to 10 years or beyond in exceptional circumstances.

Cover on transactions on short credit terms is usually made available under an umbrella policy that requires the exporter to offer for insurance, if not the whole of this export turnover, a spread of his business that is acceptable to the ECA. Cover may be made available against the risks outlined above from date of contract or from date of shipment. Exporters of specialised goods likely to suffer a loss should an insured risk occur before shipment, are likely to be interested in the former cover; exporters of more standard items normally find cover from date of shipment adequate for their needs. Premium rates reflect the credit terms involved and the ECAs perception of the risk, in particular its political risk component. The proportion of loss covered is usually less than 100% in order to leave the exporter with an interest in the debt and its recovery. In the case of most causes of loss claims are paid at a set period after the occurrence of loss to allow time for delays in payment for administrative reasons etc. to be remedied.

Cover for transactions on medium and long-term credit is, usually, provided by the issue of an individual policy for each transaction. The general terms and conditions of such cover are similar to those noted above in respect of short-term cover.

A number of ECAs also provide guarantees to banks who finance the exporter's costs of production. These facilities are especially important for many small and medium sized exporters who would not otherwise be able to satisfy the security requirements of their financiers. This has emerged as a major problem in many developing countries and such facilities play an important part in the activities of ECAs in countries such as India, Philippines and Indonesia.

(d) PROCEDURES

The administration of cover involves:

- The establishment of an underwriting policy towards particular foreign markets and the assessment of the creditworthiness of particular buyers.

This requires the export credit insurer to build up a database of credit information and payment performance on the overseas customers of their export clients. Such information is obtained primarily from specialist credit enquiry agencies and banking sources. However some limited discretion to operate without reference to the ECA may be agreed for short term cover on the basis of the ECAs evaluation of the exporter's past experience and credit control system;

- the notification by the exporter to the ECA of business conducted under short term cover thus providing the basis for the periodic collection of premium and the monitoring of the insured's performance; premium for medium and long term cover is usually collected when the insurance policy is issued;

- the notification by the exporter to the ECA of potential losses;

- the establishment of claims examination and payment procedures;

- procedures for the pursuit of debts that have given rise to claims payment i.e. recoveries.

(c) INTERNATIONAL CONSTRAINTS ON ECAs OPERATIONS

The terms of payment supported by ECAs are, in the interest of prudent underwriting and the desire not to distort normal trading practices, regulated by voluntary agreements between ECA members of the International Union of Credit and Investment Insurers (the Berne Union). Additionally, the terms of payment for medium and long term credit transactions two years and over are regulated by the OECD Arrangements on Guidelines for Officially Supported Export Credits (the Consensus) which sets minium interest rates, minimum down payments and maximum credit periods permissible for such transactions.

The Berne Union understandings on maximum terms of payment are:

i)	Raw materials and semi manufacturers	- 6 months	
ii)	Consumer goods and consumer services	- 6 months	
iii)	Consumer durables (including related. services)	- Normally 6 months but maximum of 2 years	
iv)	Parts or components (including related services) to be incorporated into quasi capital or capital goods	~ Normally 6 months but up to 5 years depending on life of the part and unit value	
v)	Quasi capital goods (including related services)	Minimum Contract Value	Credit Length
		$75,000	3 years
		$150,000	4 years
		$300,000	5 ycars
vi)	Capital goods and project services	- 5 years or longer	

The following specific agreements apply

The current Agreements are:

<u>Breeding Animals</u>

Normal credit terms are 180 days

The maximum credit terms currently permitted for cattle are:

2 years credit for contracts up to $150,000 and 3 years for contracts over $150,000 but, where more than 2 years credit is granted, a downpayment by delivery of 15% of the contract price should be stipulated.

Bus and Bus Chassis

The maximum credit terms currently permitted are:

5 years from delivery with 15% on or before delivery

Containers and Semi-Trailers

The maximum credit terms currently permitted are:

5 years from delivery with 15% on or before delivery

Agricultural Vegetable Reproduction Material

The maximum credit terms currently permitted are:

360 days from delivery

Paper/Pulp and Lumber/Timber

The maximum credit terms currently permitted are:

180 days from delivery

Fertilisers, Insecticides, Pesticides and Fungicides

The maximum credit terms currently permitted are:

12 months from delivery

On-highway Lorries and Lorry Chassis

The maximum credit terms currently permitted are:

5 years from delivery with 15% on or before delivery

5. INVESTMENT INSURANCE

(a) PURPOSE

Apart from supporting the export of goods and services, twenty four of the Berne Union Members provide a foreign investment insurance facility to protect investments by their nationals in foreign enterprises against loss from such events as expropriation, non-transfer of dividends, war and civil strife. The outstanding amount insured is approximately US$ 43.5 billion.

Two (TREUARBEIT in Germany and OPIC in USA) are specialised in investment insurance, while the others are also export credit insurers. In addition, MIGA, the Multilateral Agency created by the World Bank to guarantee investment is also a member.