

SECTION 4

SHORT TERM TRADE INSURANCE

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CHAPTER I

WHAT IS TRADE INSURANCE?

Before we look at what types of policies are suitable for an exporter, or seller let us discuss the general concept of trade insurance.

In a nutshell, the concept of trade insurance is the "the insurance of non-payment of trade debts where such non-payment arises from commercial or non-commercial risks".

Trade insurance is quite different from marine cargo insurance or fire insurance policy, which covers the risk of damage or loss of the physical goods. Trade insurance covers against external causes which prevent you, as the exporter, from collecting payment for goods supplied. In international trade, as long as you are selling on credit you are exposed to the risks of your buyer going bankrupt or defaulting on payment because of poor commercial morality, tight cash flow or refusing to take delivery of the goods for no valid reasons. Further, when you sell overseas you are exposed to even more risks i.e. the country-related risks. These can be a blockage or delay in the transfer of payment, imposition of import restrictions or cancellation of a valid import licence. These actions are usually taken by a government to halt a deteriorating balance of payment situation if the country's foreign reserves are running low. Another country risk is war or political disturbance in the buyer's country.

With credit insurance, should any of the above events occur after the goods have been shipped and you can not collect payment, you can claim indemnity under the policy.

WHY DO WE NEED TRADE INSURANCE?

An exporter can benefit from trade insurance in three ways which can be categorised under the tenets of promotion, protection and profitability.

Promotion

You have an advantage over your competitors when competing for overseas orders if you are able to give credit instead of insisting on a Letter of Credit (L/C). Firstly your buyer may not have access to any L/C facility. Or, if he has access to such a facility, the cost of opening an L/C may too high. In certain countries, it is a regulation that an importer deposits 150% of the value of the LC to be opened.

Secondly, export promotion must be broad-based. New markets must be tapped to expand sales. If you are a manufacturer, there must be viable outlets for your products so as to keep your production lines active. You should not limit your export sales to one or two markets. Your markets should be well spread so that you will not be vulnerable even if there is a change in the country conditions of one or two of your markets. Credit insurance therefore not only helps you to develop new markets but also to be more competitive in giving credit.

Protection

While it is every businessman's dream to make more sales and profits, the sale is not complete if payment is not received. In other words, there is no benefit in making the sales unless your buyer pays you promptly. Trade debts usually form one the main items of the current assets of a trading or manufacturing company. Trade insurance therefore protects you from the loss of a valuable asset, which can affect your cashflow. If your business is concentrated on a handful of key buyers, the failure of just one of them can in turn ruin your business. This is what is called the "domino effect".

Profitability

Let's assume that your cashfiow is able to withstand a bad debt loss, profitability would be affected as you would need to recoup the loss from future sales. Assuming that the business makes a gross profit margin of 20% of each sale, you have a bad debt of \$100,000 you would have to chalk up additional sales of \$200,000 to recoup the loss. In other words, there is no profit from these sales.

An alternative to buying trade insurance is to self-insure. But this is only feasible for very large organizations where total cashflow is substantial and who can form a fund to be invested. For the average business, the resources would be better used as working capital rather than to be set aside as a reserve against losses. Also the amount of assets, which can be set aside as reserves is usually not sufficient to cushion a bad debt loss on a key buyer.

TYPES OF POLICIES AVAILABLE

There are different types of policies which are available to an exporter, the most usual is the Comprehensive Short Term Policy for credit terms of up to 180 days.

The Comprehensive Short Term Policy

This policy is suitable for a trader or manufacturer who exports goods which are repetitive in nature and the credit period involved does not exceed 180 days. In certain circumstances, trade credits of up to 720 days could be considered.

The Short term policy can be issued either on a "Shipment" or "Contract" basis. The main difference is that the former cover begins from date of shipment and the latter from the contract date.

A manufacturer of customised goods (i.e. non-standard goods) is usually advised to take up a Contracts Policy to give him the additional protection during the manufacturing or pre-shipment period to protect him against the buyer's insolvency. The pre-shipment loss would have been the material and other manufacturing costs incurred based on the buyer's orders. The loss would be even greater if it is difficult to find another willing buyer for the customised or partly produced goods.

The Short Term policy covers all the commercial and non-commercial risks described in the first section and the insured indemnity is usually 85% of the loss except where the loss is due to the buyer rejecting the goods which have been shipped. In the latter case, the exporter is required to bear the first 20% of the gross invoice value. Thereafter, the balance of the loss shall be indemnified at 85%.

Besides the Shipments or Contracts Policy, domestic sales may, by some Trade Credit Insurers, also be insured under the Domestic Trade Policy. The insured risks would be buyer's insolvency and default. Insured indemnity usually remains at 85%.

Policy Structure

Under the Comprehensive Short Term Policy, the basic Policy structure generally covers the following articles:

1. Risks insured, contracts covered
2. Risks excluded, limitation of liability
3. Insured's obligations
4. Loss ascertainment
5. Action after claims payments
6. General Conditions and Definitions

However, there may also be occasions where some terms under the Policy may need to be changed to take cognisance of the nature of the insured business and trade practices. These changes can be varied by special endorsements to the policy. An example would be the exclusion of the non-acceptance risk if the insured goods are perishable items.

Premium Rating and Calculation

There are many variations of premium rating and calculation adopted by different export credit agencies. Premium rating can be based on a matrix rate or a single rate. Short Term policy premium rating may be done in both ways depending on the insured portfolio.

A matrix premium rate is usually given when the insured portfolio consists of the following:

- Well spread markets ranging from good to higher risk markets;
- The payment terms offered to buyers vary.

A single premium rate is given when the payment term offered to buyers is constant and markets are confined to one category.

The premium for each policy will be rated on many factors based on information provided by the exporter / insured in the Proposal Form and interviews / discussions with the exporter / seller. The exporter / seller will have to complete and supply information in respect of the proposed business to be insured - such as markets, type of goods, loss experience, credit control and spread of buyers to be insured in the Proposal Form. The Proposal Form is an integral part of the Policy.

In determining the premium rate, these factors are taken into consideration:

- a) Type of Company and nature of business of the exporter / seller;
- b) Business experience and turnover offered (sales volume and market spread);
- c) Payment terms offered to buyers;
- d) Credit control and loss experience

Payment of premium is charged on insured turnover.

RENEWING THE POLICY

The policy is usually valid for a year and annual review of the policy will be made at the end of the expiry date. In renewing the policy, the insured's performance such as difficulty in servicing, slow payment of premium and claims experience will be taken into account. During the review for the renewal of a policy, it is also essential for the insurer to obtain information from the insured on his new business strategy and /or changes. In the event that there are changes, new terms and conditions will be added or deleted in the policy.

CHAPTER II

SYNOPSIS

1. What is Trade Insurance?
 - Insurance Against Non-payment

2. Service Scope
 - Credit Assessment
 - Risk Monitoring
 - Trade Support
 - Loss Minimisation

3. Pre-shipment Credit Risks

Losses before shipment

- Insolvency
- Cancellation of contract
- Country Risks

4. Post-shipment Credit Risks

Losses after shipment

- Buyer Risks
- Country Risks

5. Buyer Risks

- Insolvency
- Payment Default
- Repudiation

6. Country Risks

- Transfer Delay
- Import Ban

- Cancellation of Import Licence
- Payment Moratorium
- War, Civil Disturbance, Natural Disaster

7. Most Common Policies

(1) Comprehensive Shipment Policy (CSP)

- Domestic Exports and Re-exports
- Post-Shipment Risks

(2) External Trade Shipment Policy (ETSP)

- Third Country Exports
- Post-Shipment Risks (except certain country risks)

8. Other Policies

(1) Comprehensive Contract Policy (CCP)

(2) Comprehensive Services Policy

(3) Small and Medium Enterprises Policy (SMEP)

9. More Facilities

- Sales to Buying Offices
- Sales to Local Exporter
- Sales by Overseas Associate / Subsidiary

10. ECIC Insurance Policy

- Each Period 12 Months
- Maximum Liability
- Policy Deposit
- Policy Fee

11. Fundamental Insurance Concept

Whole Insurable Turnover

- Insuring all Credit Shipments
- Lower Premium Cost

- Improve Risk Quality & Spread

Selective Cover if:

- Volume of Business Justifies
- Quality and Spread are Acceptable

12. Credit Assessment

- Policy Underwriting
- Buyer Underwriting
- Country Underwriting

CHAPTER III

EVALUATING TRADE INSURANCE

SYNOPSIS

WHAT DO MEMBERS ACTUALLY DO TO ASSESS EXPORTERS?

- Importance in exporter assessment
- Past - insurable turnover and the sector are essential parameters
- Present - tendency is to better identify the exporter's profile

OBJECTIVES

(1) Exporter vs Credit Insurer - striking a balance

- The balance may be jeopardised if
- Exporter operating in adverse sector
- Exporter facing substantial bad debt losses
- High management cost of small policies

(2) Credit insurance to meet exporter's requirement

(3) Offer price allows for

- wider range of parameters e.g. quality of exporter
- variants resulting from enhanced flexibility in the proposed products and services

SHARING OF EXPERIENCE

Can exporters be ruled out because of:

- their size?
- their sector?
- their financial situation?

Must the quoted price be the primary selection parameter?

FACTORS TO TAKE INTO ACCOUNT IN ASSESSING QUALITY EXPORT ACTIVITY

- Total Export Sales

- Sectors
- Bad Debt Losses
- Credit Management Organization and Methods

(1) TOTAL EXPORT SALES (Key Parameters)

(2) SECTORS

- Essential parameter considering major disparities resulting from known loss ratios in certain sectors
- Need to identify
 - exported products or services
 - exporter is a
 - manufacturer?
 - trader?
 - services provider?
 - exporter's customer base
 - industry
 - wholesalers
 - retailers
 - others

(3) BAD DEBT LOSSES

- Increasing emphasis on this factor
- Credit insurers to determine the following from exporter's books:
 - the provisions
 - the bad debt losses for last 3 financial years
 - the amount and number of outstanding payments
 - the major failures

(4) CREDIT MANAGEMENT ORGANIZATION AND METHODS

- Terms of payment - fundamental information item
- Whether exporter has credit management department

SHARING OF EXPERIENCE

- What is the insurer's view regarding credit management by the exporter?

QUALITY OF APPLICATION

- Obtain as much detailed information as possible in the application form

CUSTOMER BASE SURVEY FORM

- Appended to application
- Exporter to indicate
 - names and addresses of largest customers
 - terms of payment
 - credit limits applicable

OFFER

- Two important parameters in setting quoted prices
 - amount of insurable turnover
 - loss ratio
- Other factors discussed earlier are used to sharpen the quotation

FLEXIBILITY

- Risk sharing particularly on private buyers
 - 90/10 to 50/50
- Threshold
 - used to shift low risks (amounting to several thousand dollars) to the insured
 - limits insurer's management cost

FLEXIBILITY

- First loss
 - Insured assume first loss
 - Reduce management cost
 - Reduce loss ratio
 - Reduced tariffs

SHARING OF EXPERIENCE

- Position of members regarding flexibility in general
- To whom should it be offered?

SPECIMEN - APPENDIX I

Questionnaire to Prospective Policyholder

Name of Company _____

Address _____

A. GENERAL INFORMATION

- 1) Economic Form _____
- 2) Business Category (Exporter / Mfr./Both) _____
- 3) Registration Date _____
- 4) Paid up capital _____
- 5) Ratification Organization of Foreign Trade Business _____
- 6) Shareholders _____
- 7) Management Background _____
- 8) No. of employees _____
- 9) Space of premises _____
- 10) Parent / Associate / Subsidiary companies _____

10). Major export markets

Market	Annual Turnover	Breakdown By Terms of Payment		
		LC	DP	DA & OA

11) Goods exported

Goods Exported	Percentage

B. BANKERS

- 1) Names & branches _____
- 2) Amount of facilities _____

C. COMPANY OPERATIONS

1) Total Turnover Direct Export \$ _____ Local Sales \$ _____

2) Present Terms of Payment for Export

LC _____ % DP _____ % DA&OA _____ %

3) Pattern of Shipments Regular _____ Seasonal _____
Peak Season _____

4) Buyer Profile to be Covered

Estimated credit turnover for the next 12 months	No. of Buyers
UP to \$1,000,000	
\$1,000,001 to \$5,000,000	
Over \$5,000,000	

5) Overdue payment encountered in last 2 years:

Buyer Name & Country	Approximate Amount (\$)	Terms of Payment	Due Date	Reason for Non-Payment

D. Buyer Information

1) Two Major Buyers for Cover

1 Buyer Name		
2. Buyer Address		
3. Credit Limit Applied		
4. Terms of Payment		
5. Goods Exported		
6. Order Schedule		
7. Bad Debt/Overdue Record		
8. Past Trading Experience		
a) No. of Years		
b) Turnover for the last 12 months		
9. Management Background		
10. Financial Information Available (Y/N)		

SPECIMEN - APPENDIX II

Name of the Exporters:

PROPOSAL FOR A COMPREHENSIVE POLICY (SHIPMENTS)

We have read a specimen of your Comprehensive Policy (Shipments), and request that you will inform us of the terms on which you are prepared to pay to us a percentage of the amount of any loss, as therein defined, that we may sustain in respect of contracts made with overseas buyers for the sale of goods wholly or partly produced or manufactured within Malaysia hereinafter referred to as "Exports", and under which contracts goods are exported from Malaysia during the period from to by reason of the occurrence after the export of such goods of any of the causes therein defined.

DECLARATION

1. NATURE OF GOODS TO BE COVERED UNDER THE PROPOSED POLICY

2. NATURE OF BUSINESS (MANUFACTURER/MERCHANT)

3. EXPORT TURNOVER We give below a breakdown by countries of our total export turnover (shipments destined for an overseas consignment stock should not be included) worldwide during the last twelve months and of our estimated total export turnover worldwide during the period to which the proposed Policy is to apply. Our export sales to our associated companies are included in Table 1 but direct business with buyers in the market concerned, are shown separately.

Table 1 - Country Turnover Analysis

1 BUYERS' COUNTRIES (in alphabetical order)	2 Actual Turnover during last 12 months	3 Estimated Turnover for next 12 months
	M\$	M\$
Total	M\$	M\$

Table 2 - Total Estimated Turnover Analysis relating to the estimated turnover for next 12 months shown in column (3) of Table 1 above.

	CAD or SID/DP	Up to 180 days
	M\$	M\$

(a) Secured by Unconfirmed Letters of Credit		
(b) Unsecured		
Total	M\$	M\$

Note: In Tables 1 and 2, the figures should exclude any contract in relation to any goods exported thereunder where:

- (i) irrevocable payment in full in Malaysia is made therefor prior to the date of, such exportation or payment is made against documents under an irrevocable letter of credit confirmed before exportation by a Bank in Malaysia.
- (ii) terms of payment exceed 6 months credit.

If more convenient. Actual Turnover of the most recent financial year may be given in Column 2 of Table 1.

4. **OVERDUES** Our current overdues in respect of payments outstanding for more than three months from the due dates are shown hereunder:

BUYER'S NAME & ADDRESS	Amount	Due Date of Payment:

5. **BAD DEBTS** Our actual losses incurred on all buyers overseas arising only from the insolvency of the buyer or the buyer's failure to pay, for the previous three completed years, and the subsequent period to date have been as follows:

	For each of the three financial years ending			Subsequent period to date
	19	19	19	19
	M\$	M\$	M\$	M\$
Total bad debts				
Total export turnover				

Note: The total export turnover for each of the respective years should be completed accordingly even if no bad debts were sustained.

6. SIZE OF ACCOUNTS The approximate number of our existing accounts (i.e. Credit Limits) are as follows:

Number of accounts on secured terms	Number of accounts on unsecured terms	Credit Limits*
		Less than M\$1,000
		M\$ 1,001 M\$ 2,500
		M\$ 2,501 M\$ 5,000
		M\$ 5,001 M\$10,000
		M\$10,001
		M\$25,000 M\$25,001
		M\$100,000
		Over M\$ 100,000

* A Credit Limit for any one buyer is the maximum amount outstanding for payment at any one time after the goods have been exported and before they have been paid for.

7. CREDIT CONTROL

(a) We give opposite the sources from which we obtain information regarding our buyers or prospective buyers.	Intermittently / at regular intervals / rely entirely on our own experience
(b) We check the standing of our buyers with sources at (a) as shown opposite (Delete items not appropriate)	
(c) The bank and particular branch through which we operate is shown opposite	

8. We have not entered into any contract of insurance or indemnity relating to any contract to which this Proposal applies in respect of any cause of loss covered by the Comprehensive Policy (Shipments) and we will not enter into any such contract of insurance or indemnity without your consent in writing.

9: We are not aware of any circumstances relating to any particular buyer or contract which might adversely influence your acceptance of any of the risks submitted.

10. We agree that, unless otherwise agreed by the Company in writing, the Company shall be under no liability in respect of:

(a) any contract made with any buyer in whose profits we have any interest, direct or indirect, or who has any interest in our business, or

(b) any contract made with any buyer in relation to any goods exported thereunder after we have learnt that he is in financial difficulties or that his position appears to be such as to make exports to him undesirable.

11. We undertake to declare under the terms of the Policy all exports made to any and every buyer in all countries, including those specified in paragraph 3 hereof and any other countries to which we may make exports unless otherwise agreed by the Company in writing.

12, We undertake to carry on our business with due care in making contracts and exports and with due regard to the conditions of the contract and the trustworthiness of the buyer.

13. All discussions and correspondence in connection with this Proposal and with any Policy arising therefrom are to be treated by both sides as confidential, and we undertake not to disclose either the existence of the Policy or any of the details thereof to our agents or to the buyers or to any other person or concern, other than in confidence to our bankers, without the prior consent of the Company in writing.

14. We certify that the representations made and facts stated by us are true, and that we have not misrepresented or omitted any material fact which might have a bearing on the Policy and we agree that such representations and facts shall form the basis of and be incorporated in the Policy and that the truth of such representations and facts and due performance of each and every undertaking contained herein or in the Policy shall be a condition precedent to any liability of the Company thereunder.

Exporter's Name:

Exporter's Address:

.....

Company's -Stamp:

Signature:

Capacity of signatory

Date:

- Note: 1. In the case of incorporated companies this Proposal should be signed by an authorised officer for and on behalf of the company and should state the capacity in which the signatory acts (eg. Managing Director, Secretary).
2. In the case of partnerships this Proposal should be signed by a partner in the firm.
3. In the case of sole proprietorships this Proposal should be signed by the proprietor of the firm.
4. The words NIL' or NOT APPLICABLE' should be entered in any space where appropriate.
NO SPACE SHOULD BE LEFT BLANK.
5. If space in any of the above tables is insufficient, please attach separate SIGNED statements.

SPECIMEN - APPENDIX III

**COMPREHENSIVE POLICY
PROPOSAL SUBMISSION
(NEW / RENEWAL BUSINESS)**

Name of Exporter _____

Address _____

 _____ Tel. No. _____

Fax No. _____

Proposed Policy Period _____ Ref. No.: _____

Other Policies BEFIP expiring _____ Others _____ Expiring _____

1. Type of Company	<input type="checkbox"/> Sole Proprietorship <input type="checkbox"/> Partnership <input type="checkbox"/> Private Limited <input type="checkbox"/> Public Company <input type="checkbox"/> Branch Office Date Incorporated: _____ Date Export Commenced: _____	
2. Parent (P) and Subsidiary (S)	<input type="checkbox"/> _____ <input type="checkbox"/> _____ <input type="checkbox"/> _____ <input type="checkbox"/> _____ <input type="checkbox"/> _____	Country _____ _____ _____ _____ _____
3. Board of Directors	_____ _____ _____	Designation _____ _____ _____
4. Management Team	_____ _____ _____	Designation _____ _____ _____

5. Capital Structure	Authorised Capital _____	<u>Ownership</u>	
	Paid-up Capital _____	Bumiputra _____%	Local _____%
		Foreign _____%	
6. Brief Description of goods involved			
7. Overdue / Bad Debts Experience (exports only)	Amount RM _____ Due Date _____ Payment Terms _____	Reasons: _____	

8. Renewal of Policy a) Past Claim Experience	RM _____ Date Claim Paid _____	Cause of Loss _____	
		: _____	
9. Policy Assignment	<input type="checkbox"/> Required <input type="checkbox"/> Specific Transaction <input type="checkbox"/> Whole Policy <input type="checkbox"/> Buyer <input type="checkbox"/> Country <input type="checkbox"/> Not Required		
Name & Address of the Bank	_____		

10. Proposed Estimated Turnover

ACTUAL						
Countries	Market Grading (Current)	Estimated Export Turnover for past 12 months RM	Export Declared RM	Premium Billed RM	Export for next 12 months RM	Markets to be Excluded
Terms of Payment: ILC		0	0	0	0	0
Non-ILC		0	0	0	0	0
TOTAL		0	0	0	0	0

11. PATTERN OF BUSINESS OFFERED:

Total Estimated Insurable Turnover RM _____

LESS, if applicable, total value of business in markets with associated companies RM _____

a) **NET TURNOVER FOR " WHOLE TURNOVER" POLICY** RM _____

or **LESS** , if applicable, total value of business in excluded markets or/and ILC terms. RM _____

b) **NET TURNOVER FOR "SELECTIVE BASIS" POLICY** RM _____

Turnover offered in A and B markets RM _____

Turnover offered in C and D markets RM _____

c) **CONTRACTS IN HAND** not yet shipped: Total Value RM _____

12. Assessment of Exporter's Status

Std = Base ("0" Score)

Criteria	Premium Loading (+ OR -)		Remarks (if any)
	1. Type of Company	Public / Sdn. Bhd.	
	Proprietorship / Sole Proprietor	+5	
2. Nature of Business	Manufacturer	Std	
	Merchant	+5	
3. Type of Goods	Manufactured/Com.	Std	
	Perishable	+10	
4. Turnover	1 m and below	+10	
	1 m to < 3 m	+5	
	3 m to < 5 m	Std	
	5 m to < 10 m	-5	
	10 m to 20 m	-10	
	Each 10 m		
	(Additional -10)	%	
5. Exporting Experience	No experience	+10	
	L/C Exports	5	
	< 3 years	+5	
	< 5 years	Std	
	Above 5 years	-10	

6. Credit Control	Maintains Credit Department	Std	
	Regular Check	-5	
	None	+10	
7. Overdue as % of turnover	Bad Debts > 5%	+10	
	Bad Debts < 5%	+5	
8. Spread of business	Whole turnover	Std	
	ILC Exclusion	Std	
	<50% CAD	+5	
	DP Exclusion	+10	
	Selective Market	+10	
	Divisional Cover	+10	
	One Market	+20	
	One Buyer	+20	
9. Performance (Renewal)			
a) Premium Contribution	> RM20,000	- 10	
	> RM 5,000	-5	
	< RM 5,000	Std	
b) Claims Experience	> RM10,000	+10	
	> RM 5,000	Std	
	Nil	- 5	
c) Premium Payment	Outstanding	+5	
	Nil if contribution >RM5,000	- 5	
	Others	Std	

13. Remark(s) [if any]

a) Premium Contribution RM _____ Premium Outstanding RM _____

b) Coverage: % to be offered _____ Tax RM _____
Exporter's gross profit margin _____
Exporter's net profit margin _____

c) Any comments on markets / Countries

Subject is continuing the policy to cover their export to Iran on D/P for sale of TV sets for USD 200,000.00 of which 10% is paid in advance. No declaration was made during the last policy years.

Recommended to be approved. Renewal Fee: RM 100.00 (To be deducted from provisional premium).

Premium Rate: a) 1.5% on gross invoice value of goods exported to approved buyer in Russia

b) 4.0% on gross invoice value of goods exported to approved buyer in Iran.

Underwritten by : Signature

Name :

Date :