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**Insurance : IRDA's Guidelines on trade credit insurance**

## Introduction

The Authority has reviewed the credit insurance products being offered by Indian Insurers and is of the view that there is a need to standardize the features of these products and their administration. To ensure that the business of trade credit insurance is carried out according to sound insurance principles, the Authority issues following guidelines under section 14(1) and 14(2)(*e*) of the IRDA Act, 1999. The guidelines come into force with immediate effect.

## 1. Definitions

*a.* "Buyer" means a customer, or, any person, who is liable to pay policyholder, for a trade credit insurance transaction on open and agreed terms.

*b.* "Trade Credit Insurance business" means the business of effecting contracts of insurance in respect of trade credit insurance transactions.

*c.* "Trade credit insurance" means insurance of suppliers against the risk of non-payment of goods or services by their buyers who may be situated in the same country as the supplier (domestic risk) or a buyer situated in another country (export risk) against non-payment as a result of insolvency of the buyer or non-payment after an agreed number of months after due-date (protracted default) or non-payment following an event outside the control of the buyer or the seller (political risk cover). Political risk cover is available only in case of buyers outside India and in countries agreed upon at the proposal stage.

*d.* "Trade Credit Insurance transaction" means a transaction between two persons for supply of goods or services on open and agreed terms.

*e.* "Transaction on open terms" means a transaction which is not a cash based transaction.

*f.* "Trade receivable" means a receivable in the hands of seller arising out of a trade credit insurance transaction.

*g.* "Insolvency (Bankruptcy)" A judicial or administrative procedure whereby the assets and affairs of the buyer are made subject to control or supervision in the jurisdiction defined under the policy by the court or a person or body appointed by the court or by law, for the purpose of reorganisation or liquidation of the buyer or of the rescheduling, settlement or suspension of payment of its debts.

*h.* "Credit Limit" is the credit limit set by the insurer for every buyer with whom the policyholder trades. The level of the limit is set at the maximum amount in normal circumstances that can be owed by the buyer at any time. Limits shall be assessed by seller applying principles of prudence and granted at a suitable level, depending on the creditworthiness of the buyer.

*i.* The "granted credit limit" is the maximum insured credit line for a specific buyer and the policyholders can trade on an insured basis within the approved credit limit throughout the policy period without further reference to the insurer.

*j.* "Trade Credit insurance policy" is a conditional insurance contract between two parties (insurer and seller) that cannot be traded and is always directly related to an underlying trade transaction, which is either the delivery of goods or of services. The correct fulfilment of this trade transaction and satisfaction of the contract terms which is essential for credit cover to exist.

*k.* "Factoring" is the purchase of receivables by a lender/Financial Institution/Bank at a fixed date to make possible for companies to fund all or some of their invoices and thus cover their operating capital requirements; obtain cover against their customers' insolvency; obtain payment of receivables with shorter payment terms; obtain information on their customers' financial soundness; outsource or vary their administrative expenses; and optimize current assets and liabilities. A factor company does not provide cover against non-payment on its own.

*l.* "Financial Guarantee" is understood as comprising any bond, guarantee, indemnity or insurance, covering financial obligations in respect of any type of loan, personal loan and leasing facility, granted by a bank/credit institution, financial institution or financier, or issued or executed in favour of any person or legal entity in respect of the payment or repayment of borrowed money or any contract, transaction or arrangement - primary purpose of which is to raise finance or secure sums due in respect of borrowed money.

*m.* "Maximum liability amount" is maximum loss that can be sustained through one single policy. If the total loss of a policy occurring during the policy year exceeds the amount of the agreed maximum liability, the actual loss for this policy is limited to this amount. The maximum liability is often defined as a multiple of the earned premiums in a given policy contract.

*n.* "Reverse Factoring arrangement" means any arrangement in whatever name or form, between a borrower and a financier, wherein a borrower receives or is supposed to receive finance, either directly or indirectly, for borrower's purchase of trade receivables, goods or services.

*o.* "Whole turnover trade credit insurance policy" includes all buyers and insures against non-payment.

*p.* "Seller" means the policyholder who is selling the underlying goods or services.

**2. Applicability of File & Use guidelines to trade credit insurance**

1. Trade Credit Insurance shall be treated as part of the "Miscellaneous Insurance" as defined under section 13B of the Insurance Act, 1938. However, for the purpose of segmental reporting the IRDA (Preparation of financial statements and Auditor's report), Regulations, Trade Credit Insurance shall be shown as a separate segment.
2. No insurer shall issue a financial guarantee.
3. All the existing credit insurance policies remain valid as per original contract terms and conditions, till the expiry of the current contract period. The insurers are directed to review the credit- worthiness of the buyers and credit assessment and management practices of the policyholders under the existing credit insurance policies currently in force and ensure that necessary action is taken to protect the interests of the insurance company.

4. Trade Credit Insurance policies will be subject to the file & use guidelines of the Authority.
5. The insurers intending to underwrite trade credit insurance business shall file the revised products under the File & Use guidelines and these guidelines.
6. Scope of cover under trade credit insurance policy - The credit risk that is insured has to have a direct link with an underlying trade transaction, *i.e.* the delivery of goods or services. If no such direct link exists, the outstanding amount is not insurable under a trade credit insurance policy.

**3. Basic Requirements of a Trade Credit Insurance Product**

An insurer shall offer trade credit insurance product only if all requirements mentioned below are met:

1. Policyholder's loss is non-receipt of trade receivable arising out of a trade of goods or services.
2. Policyholder is a supplier of goods or services in consideration for a fair market value.
3. Policyholder's trade receivable does not arise out of factoring or reverse factoring arrangement or any other similar arrangement.
4. Policyholder has a customer (*i.e.* Buyer) who is liable to pay a trade receivable to the policyholder in return for the goods and services received by him from the policyholder, in accordance with a policy document filed with the insurer.
5. Policyholder undertakes to pay premium for the entire Policy Period.
6. Any other requirement that may be specified by the Authority from time to time.

**4. Conditions on Trade Credit Insurance**

**A. Insurer**

1. A trade credit insurance policy shall not be issued to banks/ financiers/ lenders.
2. A trade credit insurance policy cannot have a bank/financier/lender as a beneficiary of a claim or where the proceeds of the claims are assigned to the bank/financier/lender.
3. A trade credit insurance policy shall not offer cover to any receivable arising from a financial service or consultancy service.
4. The insurer while offering cover for other services shall undertake valuation of those services considering its methodology and past valuations. These services shall be offered at arms length and valued in accordance with relevant accounting standards.
5. A trade credit insurance policy can be sold only to seller on whole turn over basis covering all buyers. However an insurer may exclude certain buyer or buyers in certain regions based only on credit risk at his sole discretion.
6. The cover under a trade credit insurance policy is available only to pre-agreed buyers and up to the limits agreed. Any change in the limits can be effected only after prior approval of the insurer.
7. A trade credit insurance policy shall contain well-defined credit limits for each of the buyers and shall also contain an overall limit under the policy.

8. An insurer shall necessarily assess the credit risk of any buyer who contributes more than 2% of the total turnover of the policyholder.
9. Every trade credit insurance policy shall carry a subrogation condition and no waiver under any circumstances shall be allowed.
10. An insurer shall have the right to reduce or cancel a credit limit at any time, usually as a result of adverse or negative information. Where the policyholder has a protection for the same loss from a third party other than through the insurance policy, the insurer shall have the right to review such protection arrangement and reduce/ delete the cover under the insurance policy. This shall allow the insurer to bring down the exposure in a timely manner. The new credit limit shall apply to all deliveries that are made by the policyholder to the buyer after the date of insurer's decision to reduce or cancel the limit.
11. Every insurer shall appoint a credit management agency with the approval of the Board of Directors for the purposes of assessing creditworthiness of the policyholder and buyers, assuring that the buyers pay on time, keep credit costs low, manage poor debts in such a manner that payment is received without damaging the relationship with that buyer, etc.
12. The insurer before engaging a credit management agency shall ensure that there is no conflict of interest position of the credit management agency with the policyholder.
13. A single specific trade credit policy covering only one shipment cannot be sold to a prospect. No trade credit policy shall be insured if the buyers are very small in number and in any case where there are fewer than ten buyers.
14. No trade credit insurance policy is allowed to cover factoring, reverse factoring and bill discounting.
15. No trade credit insurance policy is allowed when governmental, para governmental agencies are the buyers.

**B. Policyholder**

1. A policyholder cannot take out more than one trade credit Policy either with the same insurer or any other insurer in respect of the same Buyer nor can the insurer issue more than one trade credit insurance policy covering risks emanating for or from the same entity.
2. A policyholder normally cannot not be offered indemnity for more than 80% of the trade receivables from each buyer or 90% of the cost incurred by seller for previous year whichever is lower.
3. A policyholder shall be obliged under the Policy to notify adverse information about the Buyer to the insurer.
4. A policyholder shall not be covered for Buyer's non-payment of a trade receivable on account of dispute with the Policyholder or supplier of the goods or services until the dispute gets resolved.
5. A policyholder shall file with the insurer a statement of credit policy, credit management and procedures for monitoring of the implementation of the credit policy as part of the proposal to seek insurance cover.

**5. Trade Credit Insurance Underwriting**

1. On the basis of information provided in the proposal form, Insurer's underwriter shall prepare a policy proposal for the prospect based on internal Underwriting Guidelines. The said guidelines shall be approved by the Insurer's Board of Directors specifying authority levels for decision on premium rates, discount in premium rates, loss deductibles, maximum liability, premium pricing in case of higher risk or loss perception, no-claim bonus, etc.
2. The insurer shall ensure that the design and rating of products is always on sound and prudent underwriting basis. The contingencies insured under the product should be clear and provide transparent cover which is of value to the insured.
3. The insurer shall utilize the services of its appointed actuary for valuation of liabilities, investment performance, solvency margin ratio, design and pricing of insurance products, creation of reserves for outstanding claims and any other matter which the Board of Directors deem fit.
4. The insurer shall take into consideration the following minimum parameters for underwriting of the Policy: (*a*) Risk Pricing; (*b*) Trade Sector/Industry of the Buyer; (*c*) Level of Insurable Turnover; (*d*) Debtors Turnover/ Velocity in comparison to the Credit Terms/Terms of Payment offered to the Buyer; (*e*) Quality of Buyer Base and spread of Risk; (*f*) Bad Debts History of the Prospect; (*g*) Internal Credit Management of the Prospect.
5. The insurer shall file with the Authority the rating model for the insurance cover to be offered in the market.

**6. Risk Management for trade credit insurance**

1. The Insurer shall have internal Risk Management Guidelines to assess trade credit risk on the Buyer, giving credit limits on the Buyer and Buyer credit limit review.
2. The insurers shall construct suitable risk management models, which articulate its risk management strategies covering the procedures, prudential risk limits, review and mitigation mechanisms, reporting and auditing systems.
3. The said Risk Management guidelines shall be approved by the Board of Directors of the Insurer and shall clearly specify authority levels for acceptance, rejection, partial rejection and review of credit limits on the Buyer.
4. The insurer shall ensure that the following minimum parameters are taken into account while framing Risk management Guidelines:
   (*a*) Financial Parameters relating to the Buyer
      *i.* Buyer turnover for current and three previous years.
      *ii.* Yearly Profitability trends, gross, operating and net margins of the Buyer for current and three previous years.
      *iii.* Yearly operating cash flows for current and three previous years.
      *iv.* Asset turnover ratio and current ratio for current and three previous years.
   (*b*) Non-Financial Information about the Buyer
      *i.* Business activity of the Buyer

   *ii.* Business and Political environment and the Industry in which the Buyer operates in
   *iii.* Promoters of the Buyer, their experience, background and track record for the past and current period
   *iv.* Market information on promoters of the Buyer
   *v.* Adverse Information about the Buyer reported by, the Policyholder Banks etc. or reported in the Media.
5. The insurer shall review and revise all returns including the system of periodical reviews submitted to the Head Office, to ensure effective supervision and control and to monitor their continued viability. Synopsis of the findings of the inspection/audit/scrutiny and compliance shall be put up to the Audit Committee of the Board at half-yearly intervals.
6. The insurer shall also provide systems and checks to ensure that delegated powers are exercised prudently and judiciously by the authorised officials and has no adverse fallout.

**7. Claims Handling**

1. The insurer shall have a comprehensive "Claims Manual" which gives the manner in which the claims shall be processed, documentation, delegation of authority, policyholders servicing, grievance redressal, etc.
2. The insurer shall also have a strong and efficient recovery mechanism in place to follow-up on defaults.
3. In respect of claims in excess of retention limits, the direct insurer shall intimate the reinsurer immediately on receiving intimation of the loss.

**8. Creation of premium and claims reserves**

1. The insurer shall create unexpired risk reserve and unearned premium reserve as per actuarial principles and having regard to the nature of incidence of risk over the policy period.
2. The Insurer shall create claims reserve as per the Claims Reserve Setting Guidelines approved by its Board of Directors.
3. The insurer shall take into account the following points for creating claims reserve :
   *a.* Determination of amount liable to be paid by the Insurer if the claim is admitted under the terms and conditions of the Policy
   *b.* Claim filed by the Policyholder
4. The insurers shall create IBNR and IBNER reserves as per the guidelines issued by the Authority from time to time.

**9. Reinsurance Arrangements**

1. The insurers shall file with the Board of Directors and the Authority details of reinsurance arrangements proposed to take care of the exposures that arise on account of the underwriting of risks taken. This should cover details of structure of reinsurance programme covering both proportional and non-proportional arrangements, net retentions, obligatory cessions, if any, security of reinsurers,

placement of reinsurance cessions, reinsurance recoveries, outstanding loss provisions, etc.

2. The Reinsurance agreement with a Reinsurer shall be appropriately drafted in order to avoid a situation wherein a Reinsurer may deny its liability to pay for a trade credit insurance claim by using any clause of the Reinsurance Agreement instead of clauses under the Trade Credit Insurance Policy issued to a Policyholder.
3. The net retentions of the insurer for trade credit insurance shall not exceed 2% of his net-worth.

**10. Qualification, Experience and Training Requirements for employees dealing with trade credit insurance**

Every insurer wanting to write credit insurance shall ensure that decisions of acceptance of trade credit insurance business are made by persons with necessary knowledge and experience in the areas of underwriting, risks management, claims, reinsurance, etc. Brief details relating to these aspects shall be filed along with the F&U documents to the IRDA.

**11. Reporting requirements to IRDA**

1. The Insurer should report following information with IRDA:
   (*a*) Policyholder wise earned and gross written premium
   (*b*) Loss ratio for the trade credit insurance product
   (*c*) Policyholder wise - Buyer wise claims reserves
   (*d*) Policyholder wise - Buyer wise claims paid
   (*e*) Policyholder wise - Buyer wise recovery in claims recovery
2. Periodic reporting
   (*a*) the Insurer should report the above mentioned information as follows :
      (*i*) Every six months - Within 30 days of every six months ending on 30th September and 31st March
      (*ii*) Every year - within 30 days of the end of 12 month period on 31st March for each financial year
      (*iii*) Every loss known to the insurer, which is in excess of 1% of the net worth of the insurer, as and when intimation is received by the insurer.
   (*b*) The Insurer should provide for additional reports/clarifications demanded by IRDA within 15 days of the receipt of requisition from IRDA.

**12. Further powers of the Authority**

1. The Authority shall have the right to call, inspect or investigate any document, record or communication of the insurer and or Policyholder, if it is of the opinion that the continued writing of trade credit insurance business is detriment to the interest of the insurer.
2. The Authority shall declare any trade credit insurance policy granted in violation of these guidelines and other IRDA Regulations as void. The insurer shall notify this clause in all policies.

3. The Authority may suspend trade credit insurance business of any insurer, if found violating the instructions of the Authority from time to time, after giving sufficient opportunity to the insurer to be heard.