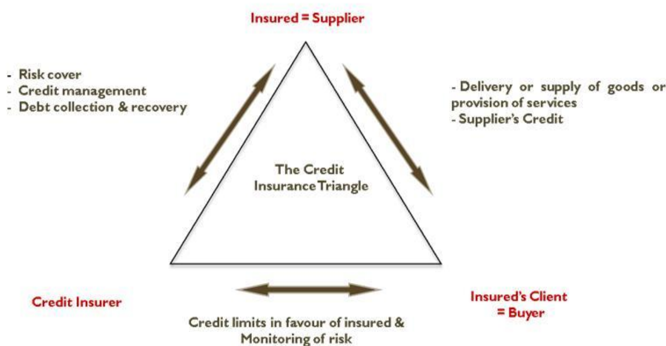
UNDERSTANDING THE CONCEPT OF CREDIT INSURANCE

By Zayd Soobedar [Credit Risk Manager]

Mr Zayd Soobedar holds a Masters in Financial Planning with over 8 years domestic and international experience in the financial services industry (including banking, insurance and economic consulting/market research) having worked mainly in Australia and the African mainland. During his career, he has worked for leading stakeholders in the domestic market including DeChazal du Mée and the State Bank of Mauritius Ltd. In addition, he has contributed to international projects for foreign bodies like Audi International, the Government of Botswana, Moody's, the World Bank, and the International Monetary Fund amongst others. His main area of expertise include: risk underwriting, risk management, corporate banking, business development, strategic planning, budgeting, product development, research techniques, debt collection and recovery.

The concept of credit insurance…

Credit insurance provides cover to businesses against non-payment of debts owed to them by business customers for goods or services provided on credit terms. It helps to foster businesses' commercial development all over the world by securing and optimising trade receivables' management. Since its inception following the two world wars in the 1940's, this specialised insurance has gradually gathered momentum and has become one of the major tools for credit risk mitigation in modern business management in most European markets including France, United Kingdom, Germany, Spain, Netherlands amongst other.



…reaching the shores of Mauritius

However, on a domestic perspective, the concept of credit insurance is relatively new. There have been some unfruitful attempts to introduce this line of business back in the 1990's mainly through international agencies. However, encouraging signs for the product's potential growth were witnessed as from 2002 with the introduction of a specifically-designed product by Atradius (2nd world largest credit insurer) which was linked to banking facilities mainly for discounting purposes by The Mauritius Commercial Bank.

Another application of credit insurance is for non-recourse factoring. CIM Factors started to provide this service by insuring the credit risk of the invoiced debtors with Euler Hermes (through a fronting via CIM Insurance) since 2006.

In the same vein, this had set the groundwork for further development of credit insurance in Mauritius. The revolution and concrete developments in this particular field were finally triggered by the advent of **C**redit **G**uarantee **I**nsurance Co. Ltd in February 2009, which significantly contributed to bolster awareness of this risk management tool among the local stakeholders. The 2 main shareholders of CGI are Prudence Holding Ltd and The Mauritius Commercial Bank. Atradius and Atradius Re act as technical partners for the first domestic credit insurer. After 2 years in operation, CGI currently insures over Rs6billion worth of turnover for its customers. Projected insurable turnover is expected to hit the Rs10billion mark by the end of 2011 with around 3,000 credit limits on issue.

CGI has gradually developed an expertise for domestic and regional risks (including the African continent and India) in addition to Europe and other developed nations, where Atradius has a stronghold in terms of a very large information database. For regional markets, Africa and India, CGI has strategic agreements with leading and reliable information service providers and fellow credit insurers in those regions.

In addition, CGI provides cover to MCB Factors for offering non-recourse factoring services launched in 2010. Nowadays, all 3 major international credit insurance players (Euler Hermes, Atradius and Coface) are present directly and indirectly in the market. The Coface scheme was initiated by the State Investment Corporation Ltd in 2010 mainly as a credit risk mitigating measure for local exporters.

Outlook 2011: Mired in dark clouds…

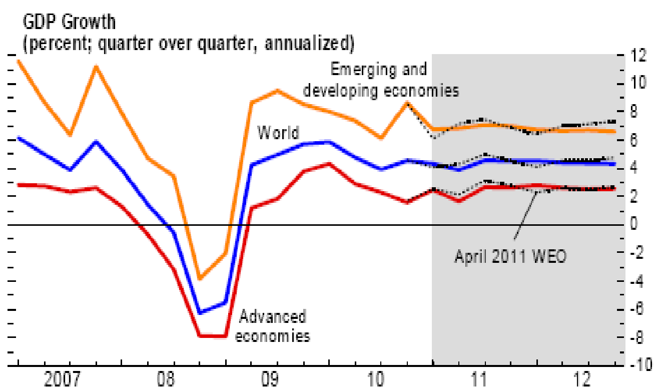
The 2008 world economic crisis has not left our main traditional export markets unscathed. The past couple of years is full with shocking evidence of crumbling giants once thought to be well-anchored and unwavering. Despite a slight recovery noted in 2010, the outlook for 2011 is mired in dark clouds with several economic forecasts facing increasing downward pressure compared to earlier more optimistic forecasts.

			Projections		Difference from April 2011 WEO Projections		Estimates	Q4 over Q4 Projections	
	2009	2010	2011	2012	2011	2012	2010	2011	2012
World Output	**–0.5**	**5.1**	**4.3**	**4.5**	**–0.1**	**0**	**4.7**	**4.3**	**4.4**
Advanced Economies	**–3.4**	**3**	**2.2**	**2.6**	**–0.2**	**0**	**2.7**	**2.3**	**2.6**
United States	–2.6	2.9	2.5	2.7	–0.3	–0.2	2.8	2.6	2.5
Euro Area	–4.1	1.8	2	1.7	0.4	–0.1	2	1.8	2
Germany	–4.7	3.5	3.2	2	0.7	–0.1	3.8	2.6	2.4
France	–2.6	1.4	2.1	1.9	0.5	0.1	1.4	2	2.1
Italy	–5.2	1.3	1	1.3	–0.1	0	1.5	1.3	1.2
Spain	–3.7	–0.1	0.8	1.6	0	0	0.6	0.9	2
United Kingdom	–4.9	1.3	1.5	2.3	–0.2	0	1.5	2	2.4
Other Advanced Economies	–1.1	5.8	4	3.8	0.1	0	4.7	4	4.3
Newly Industrialized Asian Economies	–0.7	8.4	5.1	4.5	0.2	0	5.9	5.1	5.3
Emerging and Developing Economies	**2.8**	**7.4**	**6.6**	**6.4**	**0.1**	**–0.1**	**7.5**	**6.9**	**6.6**
Central and Eastern Europe	–3.6	4.5	5.3	3.2	1.6	–0.8	4.9	5.1	2.2
Developing Asia	7.2	9.6	8.4	8.4	0	0	9.2	8.4	8.6
China	9.2	10.3	9.6	9.5	0	0	9.8	9.4	9.5
India	6.8	10.4	8.2	7.8	0	0	9.7	7.7	8
ASEAN-5	1.7	6.9	5.4	5.7	0	0	6	5.4	5.8
Middle East and North Africa	2.5	4.4	4.2	4.4	0.1	0.2	. . .	. . .	. . .
Sub-Saharan Africa	2.8	5.1	5.5	5.9	0	0	. . .	. . .	. . .

…with growing uncertainties in our main export markets…

According to the ***IMF World Economic Outlook - June 2011 update***, *"Activity is slowing down temporarily, and downside risks have increased again. The global expansion remains unbalanced. Growth in many advanced economies is still weak, considering the depth of the recession. In addition, the mild slowdown observed in the second quarter of 2011 is not reassuring. Growth in most emerging and developing economies continues to be strong. Overall, the global economy expanded at an annualized rate of 4.3 percent in the first quarter, and forecasts for 2011–12 are broadly unchanged, with offsetting changes across various economies. However, greater-than-anticipated weakness in U.S. activity and renewed financial volatility from concerns about the depth of fiscal challenges in the euro area*

Figure 1. Global GDP Growth and Inflation



periphery pose greater downside risks. Risks also draw from persistent fiscal and financial sector imbalances in many advanced economies, while signs of overheating are becoming increasingly apparent in many emerging and developing economies. Strong adjustments—credible and balanced fiscal consolidation and financial sector repair and reform in many advanced economies, and prompter macroeconomic policy tightening and demand rebalancing in many emerging and developing economies—are critical for securing growth and job creation over the medium term."

Surprisingly, our main export markets are the ones which are likely to be the most affected, thus contributing to escalation in credit risk of European buyers. More recently, in September 2011, Christine Lagarde (Managing Director, International Monetary Fund) confirmed the adverse situation in main developed nations in her statement: "*the bottom line is that global activity has slowed, and downside risks have increased. At the same time, the global rebalancing of demand needed for sustainable global growth has stalled. In key advanced economies, the necessary hand-off from public to private demand is not taking place. The fundamental problem is that weak growth and weak balance sheets—of governments, financial institutions, and households—are feeding negatively on each other. If growth continues to lose momentum, balance sheet problems will worsen, fiscal sustainability will be threatened, and the scope for policies to salvage the recovery will disappear. In the emerging economies, performance has been considerably better. But in some countries, growth may be too fast, and policies are needed to contain overheating risks. Another issue is that in many of the key surplus economies, there has been little progress in shifting from external to domestic demand. In these economies, significant currency appreciation and structural reforms can help bring about the rebalancing needed to support strong, stable and sustainable global growth."*

…and credit risk indicators marked by volatility

The adverse economic conditions have already negatively impacted on the level of credit risk. In most of our export-oriented destinations, the number of defaults and insolvencies is on the rising trend again during the first half of 2011 following a drop in 2010. In addition, the share of past due date invoices is growing, depending upon the European country involved, and stood at anywhere between 20% and 35% during spring 2011. Moreover the proportion of uncollectable foreign receivables reported was as high as 10%.

Credit insurance provides businesses with peace of mind regarding their receivables

As per the Pareto principle, 20% of clients contribute to 80% of the turnover of most businesses. As such, default or insolvency of a major customer can adversely impact on normal business operations and may even result in insolvency in some cases. Credit insurance contributes to mitigate these credit risks.

The growing economic turmoil looming in our main export markets is likely to take its toll on credit risk in terms of soaring number of protracted defaults and insolvencies. Credit insurance is one of the best solutions to protect your business and your cash flow especially in recession times.