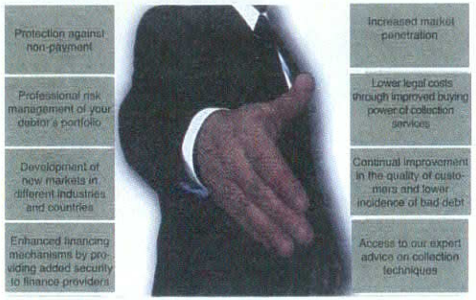
CREDIT INSURANCE: FORGING ITS WAY AMONG DOMESTIC CORPORATES

BY ZAYD SOOBEDAR
[CREDIT RISK/CLAIMS
MANAGER – CGI]

CREDIT INSURANCE...

Credit insurance covers the risk of financial loss that can occur when trade credit is offered by a business to its corporate customers. The main advantages of credit insurance as follows:



...CONTRIBUTION OF CGI TOWARDS PROTECTING CASH FLOW OF ITS CLIENTS...

In 2013, Credit Guarantee Insurance Co. Ltd (the first and only domestic credit insurer) has contributed to safeguard the cash flow of 23 clients by paying indemnities for an overall amount of over Rs23Million pertaining to 12 cases of defaults (mainly due to liquidity problems) and 11 cases of insolvency. 78% of the cases were related to domestic buyers totaling around Rs2.8Million while the remaining Rs20.6Million was split among 5 buyers abroad. In addition, CGI has also been successful in recovering around Rs5.6Million from previous claims mainly from an African buyer through its network of credit insurers on the African continent.

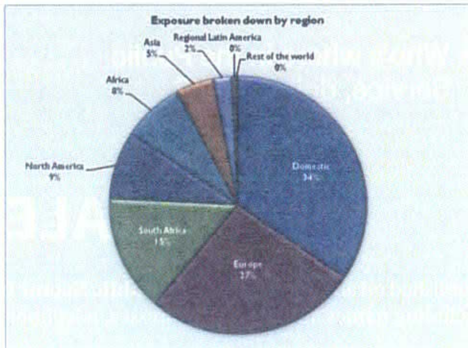
It is worthy to point out that CGI has a panel of top-rated reinsurers as well as strong shareholders namely La Prudence Holdings and The Mauritius Commercial Bank.

... GRADUALLY FORGING ITS WAY IN RISK MANAGEMENT PRINCIPLES OF DOMESTIC BUSINESSES ...

CGI will be on its 5th year operations in 2014 and since its launching in 2009, it has contributed significantly towards market education and awareness regarding this modern risk management tool. More and more businesses are adopting credit insurance and adapting it to their business model, not only to protect their cash flow, but also to have an expert debtors' risk management, which is an inherent part of the product.

As per Mr Zayd Soobedar (Credit Risk Manager of CGI), "credit insurance is a sound and proven way of outsourcing your debtors' management. You may know your own business, but it is not necessarily your specialty to assess the credit risk quality of your clients. Based on the current economic climate marked by high degrees of volatility, li-mited visibility and the fall of giants, the concept of 'too big to fail' has taken a serious blow. In fact, the risk associated with a buyer (in this case your client) is constantly changing and at times for the worst. It is our line of business and expertise to assess and monitor the credit risk level associated with your book of receivables. As at October 2013, we had around 8,000 credit limits on issue. This aggregated to over Rs10Billion cover on buyers across the globe even though our core expertise remains domestic, regional (Reunion, Madagascar, Seychelles, South Africa) and traditional markets (Europe)."

"Worst-case scenario in case of default or insolvency of your client when you have a credit insurance policy, is that you are indemnified within a period of 90 days for a case of default and 30 days for an insolvency situation, which will not hinder your cash flow, exert pressure on your overdraft facility with the bank or affect your ability to repay your debts. At the start, corporate businesses did not realize the use and importance of credit insurance. However, the perception has gradually evolved and nowadays, we have clients who do not supply to their customers until they get a credit limit approval from our underwriting team. Another issue we faced at the outset was the perception of the pricing since it was wrongly thought to be high. Nevertheless, the cost of protecting one of your main assets is not as significant as one would think. It is actually between 0.15% to 1.5% p.a of your annual estimated credit turnover. The average rate is around 0.32% p.a. Very often the cost of credit insurance is less that the bad debt figure that businesses have to write off. With the escalation in the number of defaults and insolvencies over the past few years, companies have progressively factored in their daily operations the weight and relevance of credit insurance in sound trading. As at date, we are insuring over Rs40Billion turnover for our clients and this figure is likely to double by the end of 2014," commented Mr Andy Chin Chew (Sales Manager of CGI).



	2011	2012	2013F	2014F
World Output	3.9	3.2	2.9	3.6
Advance Economies	**1.7**	**1.5**	**1.2**	**2.0**
USA	1.8	2.8	1.6	2.6
Euro Area	1.5	-0.6	-0.4	1.0
Germany	3.4	0.9	0.5	1.4
France	2.0	0.0	0.2	1.0
Italy	0.4	-2.4	-1.8	0.7
Spain	0.1	-1.8	-1.3	0.2
United Kingdom	1.1	0.2	1.4	1.9
Other Advanced Economies	3.2	1.9	2.3	3.1
Emerging Market and Developing Economies	**6.2**	**4.9**	**4.5**	**5.1**
Developing Asia	**7.8**	**6.4**	**6.3**	**6.5**
China	9.3	7.7	7.6	7.3
India	6.3	3.2	3.8	5.1
ASEAN-5	4.5	6.2	5.0	5.4
Sub-Saharan Africa	**5.5**	**4.9**	**5.0**	**6.0**
South Africa	3.5	2.5	2.0	2.9

...WITH GROWING RECOGNITION FROM FINANCIAL INSTITUTIONS...

The credit insurance project in Mauritius was initially driven by the idea of factoring companies to offer non-recourse factoring services, with less focus on its potential contribution to corporate banking.

In Europe and US, banks represent a large proportion of referrals for credit insurers. The main advantages for banks to have their clients insuring their trade receivables are enhanced security, business development opportunity, professional credit management and risk assessment of clients' debtors, debt collection (both local and international), and greater competitive edge.

The main applications of credit insurance for banks include structured financing (trade finance activities, import loans, open account discounting, invoice discounting) and general financing (mainly to protect overdraft/loan facilities repayment capacity/cash flow of businesses against unforeseen events).

However, the fact that credit insurance mitigates trade credit risks has immensely contributed to making it a popular risk management tool for domestic banks and a growing prerequisite for banking facilities as well. Some banks even have specialized structured credit insurance product for their trade finance related activities.

...DECREASED RISK APPETITE AND RESTRICTIVE GUIDELINES FOR SOME SECTORS...

The Macroprudential Policy Measures proposed recently by the Bank of Mauritius to reduce sectoral concentration in the economy especially for the construction and tourism sectors are likely to affect the liquidity and solvency position of players in these sectors, thus the credit risk level associated with businesses in these industries.

Reduced risk appetite of commercial banks for these portfolios matched by the significant slowdown and hardships experienced by businesses in these sectors over the past 2 years could prove to be the determining factor for the financial position of the market players in the coming year. The domestic outlook for 2014 involves a large degree of volatility since growth next year will be intrinsically dependent on the recovery of our main export markets.

...2014 OUTLOOK STILL MIRED BY HIGH LEVEL OF UNCERTAINTIES...

As per the IMF's World Economic Outlook 2013, "the world economy has entered yet another transition. Advanced economies are gradually strengthening. At the same time, growth in emerging market economies has slowed. This confluence is leading to tensions, with emerging market economies facing the dual challenges of slowing growth and tighter global financial conditions.

The core economies of Europe show some signs of recovery. This is the result not of recent major policy changes but of a change in mood, which nonetheless could be largely self-fulfilling if consumers and firms decide to increase spending.

In short, the recovery from the crisis continues, albeit too slowly. The focus at this time is on emerging market economies—specifically, on the combination of slower growth and tighter financial conditions triggered by U.S. monetary policy. But, in the background, other legacies of the crisis still linger and may well come back to the fore. Public debt and, in some cases, private debt remain very high, and fiscal sustainability is not a given. The architecture of the financial system is evolving, and its future shape is still unclear. These issues will continue to shape the evolution of the world economy for many years to come."

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. Credit insurance contributes to mitigate these credit risks.

The volatility present in our main export markets and also in the domestic market is likely to weigh down trading with a non-negligible probability of protracted defaults and insolvencies. Credit insurance remains one of the best solutions to protect your business and your cash flow!