# Report of IRDAI Working Group

## On

## Revisiting Guidelines on Trade Credit Insurance


भारतीय बीमा विनियामक और विकास प्राधिकरण

INSURANCE REGULATORY AND DEVELOPMENT AUTHORITY OF INDIA

**Smt. T. L. Alamelu**

**Member (Non-Life)**
**Insurance Regulatory Development Authority of India**
**Hyderabad**

**Respected Madam,**

**Re: Report of the Working Group on revisiting Guidelines on Trade Credit Insurance**

I have pleasure in submitting the Report of the Working Group on the above subject created vide IRDAI order IRDAI/NL/ORD/MISC/133/08/2019 dated 29th August, 2019.

The Report and the Recommendations contained are an outcome of extensive review of existing guidelines vis-à-vis the needs of the stake holders and changing trends of business through meetings with stake holders and intense deliberations by the Working Group. This report covers the following aspects.

1. Understanding Credit Insurance
2. Analysis of Credit Insurance Market in India and Worldwide
3. Credit Insurance for Banks and Factoring Business
4. Micro, Small and Medium enterprises
5. Online Trading Electronic Platforms such as TReDS

On behalf of the Members of the Working Group, I sincerely thank you for entrusting us with this responsibility. I also thank you for granting extension of time to the Working group to come up with a comprehensive report on the subject.

**Place: Hyderabad**

**Date: 11.05.2020**

**Atul Sahai**

**Chairman of the Working Group**

**Members**

Mr. Subrata Mondal
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## CONTENTS

## Acknowledgements

At the outset, the working group thanks Chairman, IRDAI and Member (Non-Life), for taking initiative to revisit the guidelines on Trade Credit Insurance, at the time of need, and providing an opportunity to review the existing guidelines and suggest recommendations which may improve the opportunities of the insurers in providing valuable credit insurance services to the needy sectors.

The Working Group acknowledges with gratitude the co-operation and assistance of Smt. Yegnapriya Bharath, Chief General Manager and Shri K. Mahipal Reddy, General Manager, IRDAI in reviewing the progress of the Working Group and pushing forward the regulatory perspective.

The Working Group places on record its sincere appreciation and thanks to various stakeholders including ICICI Bank, Coface, Atradius, India Factoring and other trade bodies for providing valuable contributions through their representatives and through other means of correspondence.

The Working Group extends gratitude to ECGC Limited for showing interest and nominating Mr. Subir Kumar Das, General Manager, as a permanent invitee to the Working Group meetings, whose contribution in the areas of export credit insurance to banks and exporters is highly appreciated.

The Working Group wishes to thank Mrs. Saraswathi Chidambaram, Manager, The New India Assurance Co. Ltd., for sharing her expertise and providing valuable inputs during the meetings.

The Working Group would like to specially thank IRDAI and The New India Assurance Co. Ltd., for providing the necessary space and infrastructure in facilitating the discussions.

Last but not the least the Working Group is extremely grateful to the managements of the companies/organizations that the Working Group members represent for having provided the members with time and resources for completing this report.

## Executive Summary

Trade Credit Insurance (TCI) is an effective risk management tool for the suppliers of goods and services and other financial institutions, to mitigate non-payment risks and insolvency/default of the buyers for both domestic and global scenarios. TCI thus enables suppliers in exploring new markets and expanding their businesses, which in turn results in significant increase in their sales turnover and profitability of their business. Simultaneously, TCI helps in supporting Banks, factoring companies and other financial institutions, which provide finance to suppliers by way of discounting/purchase of bills.

TCI contributes to the economic growth of a country by facilitating trade and helps in improving economic stability by addressing the trade losses due to payment risks. However, the regulatory framework must facilitate insurance companies to offer better credit insurance covers to suppliers as well as banks and other financial institutions. TCI is one of the driving factors in flourishing trade and financial markets in developed economies.

In the Indian context, the present guidelines on TCI, issued in 2016, do not allow the insurance companies to offer full fledge benefits that provides much needed protection to suppliers and restricts TCI covers to banks and financial institutions. Credit Insurance market in India is dominated by ECGC Limited, a Govt. of India enterprise which provides only export credit insurance facilities to banks and exporters. Domestic credit insurance on the other hand is also being provided by all insurance companies except ECGC.

Around 82% of the total Credit Insurance business is contributed by ECGC Limited, which is outside the purview of the Trade Credit Insurance guidelines. The balance around 18% is contributed by other general insurance companies, both public and private, governed by the Trade Credit Insurance guidelines. Credit insurance business in India, other than ECGC, has shown a growth rate of around

18% over the last two years. However, the insurance premiums amount to Rs. 277.68 cr during 2018 -19 for insurance companies other than ECGC, which is quite miniscule vis-a-vis the size of Indian Economy.

With the Govt. of India's initiative to improve businesses for the MSMEs, which are considered as the backbone of the national economic structure, it is also imperative to relax the trade credit insurance guidelines to support the business environment. The insurance companies have to be enabled to offer TCI services with enhanced covers at affordable premiums to boost the MSME sectors. At the same time, it is equally important to make availability of TCI facilities to Banks, FIs, factoring companies, etc who also provide finances & liquidity to them.

The report analyses the need to revisit the present guidelines in the context of providing necessary impetus to the economy by addressing TCI requirements of various business segments. The report provides a deep study of TCI and helps to understand the TCI business in various segments. Credit insurance markets across the globe are reviewed and regulatory framework in some of the countries have been examined. The report also provides a comprehensive study of factoring business, bank finance and business contributed by Micro, Small and Medium enterprises in India along with relevant regulatory framework.

Following are the key recommendations classified into 3 parts which have been advised by the working group study.

**Changes in Current Guidelines:**

- Certain Key Definitions in the guidelines have been modified to add better clarity & understanding.
- The indemnity provided to the policy holders should be allowed to increase from 85% to 90% for all policy holders & 95% in case of political risk for Micro & Small Enterprises.

- Every Insurer shall have Board Approved Risk Management Guidelines which should be filed with the Authority while taking approvals for this product category.
- The aggregate net retentions of the insurer for Trade Credit Insurance shall be as per the applicable reinsurance regulations & amendments thereof.

**Additions proposed to the Guidelines:**

The committee had various discussions and deliberations with various stake holders like Banks / Financial Institutions, Factoring Companies, Export Councils and Trade Bodies to understand their expectations from Trade Credit Insurance as risk mitigation tool. Keeping in mind the evolving needs of MSMEs and Banks, the committee has also suggested to add the following new options under trade credit insurance:

- Banks, Factoring Companies, FIs & similar entities shall be allowed to avail Credit Insurance to cover trade related transactions which was not permitted earlier.
- Banks, Factoring Companies, FIs & similar entities should not be permitted to cover loan default of Seller.
- No Credit Policy shall cover Reverse Factoring Transactions.
- Single buyer risk covers should be allowed only for Micro & Small enterprises.
- Single Invoices cover shall be availed on Invoice Discounting e-platforms such as TReDS or any similar types of platform.

The insurance companies will now be able to offer wider range of credit insurance products with enhanced covers at affordable premiums to boost the SME and MSME sectors.

**Working Group Recommendations:**

- Creation of a Buyer Default Database with IIB to keep a check on the defaulters & better risk mitigation process
- RBI to recognize Credit Insurance Products as risk mitigation tools for Banks to make it eligible for Capital Relief.

The work group has made the recommendations keeping in mind the TCI needs of the suppliers of goods and services, esp. Micro & Small enterprises in India and how these changes can help them with simplified and necessary risk mitigation tools. By allowing Banks, FIs and new age Invoice Discounting Digital platforms to cover trade risks, this much deprived segment will also be benefitted in getting additional liquidity from their receivables.

# CHAPTER 1

## Concept of Credit Insurance

### 1.1

Trade credit insurance (also known as credit insurance, business credit insurance or export credit insurance) is an insurance policy and risk management tool that covers the non-payment risk of buyers resulting from the delivery of goods or services. Trade credit insurance usually covers a portfolio of buyers and indemnifies an agreed percentage of an invoice/s that remains unpaid as a result of protracted default, insolvency / bankruptcy.

Depending upon the nature of business this insurance may also be offered for

- Single Buyer insurance
- Top buyer insurance
- Single shipment insurance

However, in such insurances, the premium is charged on exposures of buyers, rather on turnover.

It is purchased by business entities to insure their receivable from loss due to the non-payment of valid debt by their debtors. It can also be expanded to cover losses resulting from political risks such as currency inconvertibility; war and civil disturbance; confiscation, expropriation and nationalization.

The costs (called a "premium") for this are usually charged as a percentage of sales or as a percentage of all outstanding receivables, depending on the policy structure.

Trade Credit insurance covers have historically developed as a Business to business cover and cannot cover individuals' risk.

**1.2**

Globally Trade credit insurance is bought for three reasons:

| |
|---|
| Why Trade Credit Insurance is Purchased<br>• Risk Mitigation/Transfer<br>• Increasing the reach<br>• Manage Cash flow |

**Risk Mitigation:**

Trade credit insurance by virtue of its structure provides relief as the last resort for a seller. Wherein despite of best effort to choose the genuine buyers, provide best of products and services as per requirement and delivering as per the schedule expected from seller, the buyer fails to pay on the due date.

The policy is designed in a fashion, wherein once the buyer crosses the due date of payment, the seller is expected to inform the insurer after a pre-decided period about the non-payment. The seller however is expected to continue chasing the buyer for payment.

The insurer assesses the buyer-seller transaction for unpaid dues and assist seller to recover the over dues amicably. However, if the amicable recovery fails within a specified time, the insurer pays the seller by way of indemnity and take subrogation of right to recovery from buyer.

This way, the program assists in risk mitigation

**Increasing the reach:**

Trade credit insurers typically have large teams of risk underwriters who manage huge database for buyers across the world. Wherein these teams collate buyers' financial data, transaction data, bank details, historical business relationship with various sellers etc.

On other side for a seller, it is a herculean task for them whenever they want to diversify either by reaching new geographies, new product lines, new sectors. As the seller is new to this opportunity, they have opaque or minimum visibility of buyer's financial or intent.

Trade credit insurer here help the seller by way of providing them insight on right exposure on each buyer to start the business, monitoring the buyers for any adverse information during business and assisting the sellers with debt recovery in case of default.

This helps sellers diversify safely not only to conduct existing business safely but also expand business with confidence

**Manage Cash flow:**

Cash flow is the core of any business and globally trade credit insurance have single handedly supported businesses across the world. In today's world, because of information technology and improvement in logistics, whole sellers are reaching buyers across the world, price and product differentia have diminished.

The only differential which a seller, especially small and medium size company could be there financial strength to provide extensive credit terms. Aggressive credit terms are double edged sword wherein on one side it helps businesses to grow, but it also restricts turnover.

This is where trade credit insurance supports sellers. The seller can either buy the trade credit insurance and assign the policy to a bank and sell their receivables, thus getting immediate relief by infusion of cash in business OR

Banks buys insurance by way of factoring policies, insurance backed channel finance program, Insurance backed dealer finance program and other insurance backed trade solution to provide support to seller manage cash flow.

This cash flow thus helps sellers to reinvest in the business by realizing the receivables upfront.

## 1.3

## Fundamentals of Trade Credit Insurance

Policy holders require a credit limit on each of their buyers for the sales to that buyer to be insured. The premium rate reflects the average credit risk of the insured portfolio of buyers. Additional premium is payable if the cover is expanded to include political risks. In addition, credit insurance can also cover single transactions with longer payment terms or trade with only one buyer, normally large transactions.

Trade credit risk insurance is an insurance policy and a risk management product offered by private insurance companies and governmental export credit agencies to business entities wishing to protect their accounts receivable from loss due to credit risks, such as protracted default, insolvency, bankruptcy, etc. Trade credit insurance can also include a component of political risk insurance, which is offered by the same insurers to insure the risk of non-payment by foreign buyers due to the actions or inactions of the buyer's government. This leads to the major role that trade credit insurance plays in facilitating domestic and international trade.

Trade credit is offered by suppliers to their customers as an alternative to pre-payment or cash on delivery terms, or the need for expensive bank letters of credit, providing time for the customer to generate income from sales before paying for the product or service. This requires the supplier to assume non-payment risk. In a local or domestic situation, as well as in a cross border or export transaction, the risk increases when laws, customs, communications and customer's reputation are not fully understood by the supplier.

Trade credit insurance thus enables suppliers to significantly increase their overall sales turnover, reduce credit risk related losses and improve the profitability of their business. At the macroeconomic level, trade credit insurance helps to facilitate international trade flows and contributes to the global economic growth, allowing transactions to occur that would otherwise have been too risky. It also enhances economic stability by sharing the risks of trade losses with the trade credit insurers, who are better equipped to absorb them.

In the absence of trade credit insurance, the suppliers would have no choice but to rely on either full pre-payment for goods and services by buyers or to seek a third party which is willing to take the credit risk for a price. Hence, traditionally, trade credit insurers must compete with banking and capital market products.

The most common banking product has been the letter of credit, an established substitute for trade credit insurance, and most used in the export sector. Trade credit insurers also compete with factoring, whereby a bank or other financial firm buys a company's receivables for an immediate, but discounted payment. However, factoring companies often buy credit insurance to cover the risk of not collecting on their trade receivables, and so the two products complement one another. Until the recent credit crisis, large suppliers could also sell their receivables at a discount to capital market investors in the form of asset-backed commercial paper.

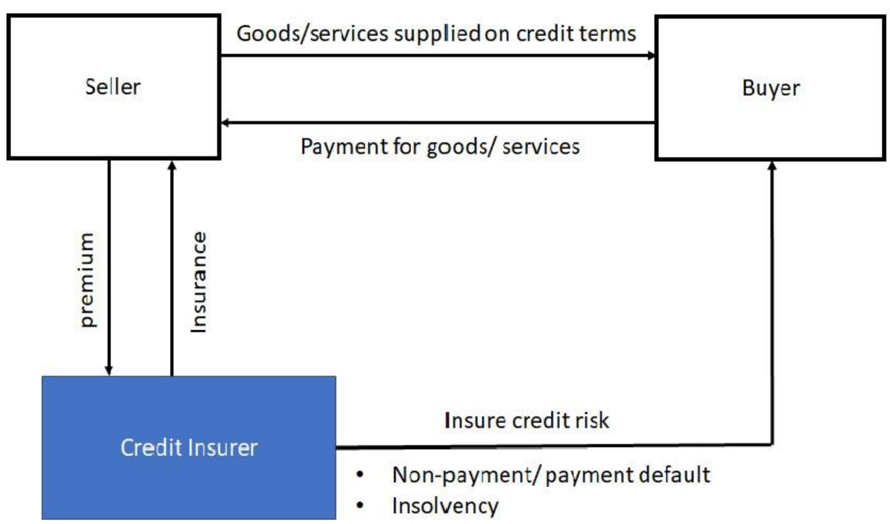
The essential value of trade credit insurance is that it provides not only peace of mind to the supplier, who can be assured that their trade is protected, but also valuable market intelligence on the financial viability of the supplier's customers, and, in the case of buyers in foreign countries, on any trading risks peculiar to those countries. As well as providing an insurance policy that matches the client's patterns of business, trade credit insurers will establish the level of cover that can reasonably be provided to the supplier for trade with each individual buyer, by analyzing the buyer's financial status, profitability, liquidity, size, sector, payment behavior and location.

The first trade credit insurance policies were offered by the British Commercial Insurance Company established in 1820 to offer fire and life coverage. However, trade credit insurance, as we now know it, was born at the end of nineteenth century, but it was mostly developed in Western Europe between the First and Second World Wars. Several companies were founded in every European country; some of them also managed the political risks associated with exports on behalf of their state. Since then, trade credit insurance has grown into a multi-billion dollar line of business.

While trade credit insurance is often mostly known for protecting foreign or export accounts receivable, there has always been a large segment of the market that uses trade credit insurance for domestic accounts receivable protection. Domestic trade credit insurance provides companies with the protection they need as their customer base consolidates, creating larger receivables to fewer customers. This further creates a larger exposure and greater risk if a customer does not pay their accounts. The addition of new insurers in this area has increased the availability of domestic cover for companies.

## 1.4

**What is Trade Credit Insurance?** For example, a SME garment manufacturer sells garments on credit to domestic and international clients. Because of previous bad experience with buyers not paying, and the need to borrow against its international receivables in order to grow its business, it seeks protection against payment delays and non-payment by its buyers. A “whole turnover” trade credit insurance policy, which covers all of the garment manufacturer’s buyers, the “good, the bad and the ugly”, is the solution. In exchange for a premium, which is based on the annual turnover and credit risk of its buyers, the garment manufacturer receives protection up to an agreed percentage of any losses incurred against late payment or the failure to pay by its buyers. It can then use this trade credit insurance policy to borrow from its commercial bank against the insured receivables, probably on better terms and conditions where the trade credit insurer is a higher rated credit risk than the garment manufacturer.




Trade credit insurance protects a supplier from the risk of buyer non-payment, which can occur due to commercial or (in the case of international trade) political risks. The commercial risks normally covered are the insolvency of the buyer and extended late payment, which is the failure to pay within a set number of days of the due date (normally 60–180 days) and is known as protracted default. Political risk involves non-payment under an export contract or project due to the actions or inactions of a buyer's government. These risks may include currency inconvertibility; transfer of payment; war and civil disturbance; confiscation, expropriation and nationalization, etc.

Trade credit insurers normally only provide cover against political risks in combination with coverage against commercial risk. Trade credit insurers generally cover short-term commercial and political risks for periods not exceeding 365 days, and normally for periods of between 90 and 180 days. Medium term cover for periods up to 5-years are a small part of the business and are generally provided by the relevant state-owned export credit agencies & now by private insurers as well.

Trade credit insurers, as with most indemnity insurance products, maintain the right to recover any losses from the buyer. This is known as the right of subrogation and allows the insurer to "stand in the shoes" of the insured supplier and take legal action against the delinquent buyers, which helps the insurer manage and contain its overall loss position.

Trade credit insurers normally establish credit limits and terms of business (e.g. maximum invoicing period and maximum payment period) on all supplier's buyers, using their extensive credit and trading information data base. In addition, a trade credit insurer may grant automatic cover on buyer risks up to a discretionary limit, which may be a percentage of the overall policy limit or the credit limit on a buyer or based on the policy holder's satisfactory payment experience on the buyer on similar payment terms during previous one or two years. These discretionary limits allow the supplier flexibility to transact business with a new buyer or temporarily increase the level of business transacted with an existing buyer, during peak business periods. However, in order to exceed these discretionary limits, the supplier would be obliged to apply for a new or increased credit limit from the insurer. The trade credit insurer also retains the right to reduce or cancel credit limits of a specific buyer if it is financial situation, or the overall political situation in the case of exports, deteriorates. These changes will only apply to future business and previously accepted risks remain covered.

Short-term trade credit insurance policies are normally “whole turnover”, covering all company’s trade receivables, either globally or on a country by country basis. While the insurer may exclude or limit cover for specific buyers it may consider high risk or not credit worthy, the supplier (insured) may not select which risks to cover, thus protecting the insurer against adverse selection whereby the insured would seek to only cover its highest risks. The premium charged by the trade credit insurer will reflect the overall credit worthiness of all the covered buyers, which makes trade credit insurance a very cost-effective method of risk management.

Most trade credit insurance policies are renewed on an annual basis, with the premiums being calculated on the insured supplier’s annual turnover and its historic loss ratio. Premium chargeable can based on underlying perceived risk associated with different payment terms and risk groupings of countries in case of exports. For new policies the premium rate is calculated at the start of the policy, and a minimum premium charged based upon the forecast turnover for the period of the policy, with the insured declaring its actual turnover on a monthly, quarterly or annual basis. Where the actual annual turnover exceeds the previously forecast turnover, then an additional adjustment premium is charged calculated using the agreed premium rate established as a percentage of insured turnover.

Trade credit insurance policies never cover 100% of the risks assumed, and normally do not exceed 85% to 90% of the losses, thus ensuring that the insured supplier is motivated to manage its buyers prudently, as the supplier will always share in any losses. In addition, limits may be set whereby a loss has to exceed an agreed threshold before a claim can be submitted to the insurer, or a deductible can be established whereby the insured supplier will assume this first level of loss for its own account.

There is also a pre-established waiting period for protracted default of between 120 and 180 days, where the supplier must make every effort to recover the outstanding payments from the buyer before the insurer will pay the loss. In the event of insolvency, it is normally required that the receiver or liquidator acknowledges the debt as being due and unpaid.

Although most trade credit insurance is written under whole turnover policies, trade credit insurers also offer a range of products to meet the specific needs of suppliers, for example:

• Specific account policies, covering only certain named accounts.

• Single account policies, covering only a single named buyer; and

• Catastrophic policies, which have a high deductible and there-fore only protect the insured supplier against a catastrophic trade credit default in excess of the amount of the deductible.

The scope of coverage will normally exclude inter-company (within same group or associates) sales; sales to governments or entitles owned or controlled by governments; goods sold benefiting from letters of credit; and cash sales.

In addition, many trade credit insurers, also offer other products consisting of credit information and receivables collection management.

**1.5**

The need for trade credit insurance arises from the common practice of selling on credit and the demand by buyers to trade on open account, where they only pay for the goods and services after having on-sold them and are not willing to provide any form of security, for example by way of full or partial advance payment, bank guarantee or letter of credit. It should be remembered that trade receivables can represent 30% to 40% of a supplier's balance sheet and companies therefore face a substantial risk of suffering financial difficulties due to the impact of late or non-payment.

Trade credit insurance, an important risk management tool for managing the risks of late payment or a complete failure to pay, offers insured suppliers several important benefits:

- It transfers the payment risk to the trade credit insurers, whose credit expertise, diversification of risk and financial strength enable them to assume these risks;
- It provides insured suppliers with access to professional credit risk expertise and related advice;
- It can help prevent insured suppliers from suffering liquidity shortages or insolvency due to delayed or non-payments;
- It reduces earnings volatility of insured suppliers by protecting a significant portion of their assets against risk of loss;
- It facilitates the access by insured suppliers to receivables financing and improved credit terms from lending institutions, some of which will insist on trade credit insurance before providing financing;
- It enables insured suppliers to extend credit to customers rather than requiring payment in advance or on delivery, or requiring security such as a letter of credit, thus allowing the supplier to effectively compete in a global marketplace where many buyers only buy on credit; and
- Allows insured suppliers to move up the value chain and accept direct buyer risk, thus cutting out the wholesaler or auction house.

While indemnification for losses is what most suppliers recognize as the main reason to purchase trade credit insurance, the most common reason to invest in a trade credit insurance policy is because it helps the supplier increase their sales and profits.

Trade credit insurance can also improve a supplier's relationship with their lender. In some cases, a bank will require the supplier to buy trade credit insurance to qualify for accounts receivable financing.

Please note that Trade credit insurance is not a substitute for transferring risk. The business must have prudent, thoughtful credit management, and sound credit management practices in place before a trade credit insurance policy can be bound.

The process of insuring accounts receivable must, by definition, involve a thorough understanding of a supplier's trade sector, risk philosophy, business strategy, financial health, funding requirements, and internal credit management processes. It should be expected that the trade credit insurer will, at a minimum, need the following basic information about the supplier's business:

- A listing of the supplier's top 10 to 20 buyers, broken down by country if applicable;
- A list of all the countries to which the supplier is selling goods and services;
- Full details of the supplier's credit management and collection procedures;
- Full details of the aged accounts receivables covering the previous 12 month's trading; and
- Three year's history of buyer delinquencies and credit losses.

The goal is not simply to indemnify losses incurred from a trade debt default, but to help the insured avoid catastrophic losses and grow their business profitably. It is therefore critical that the insurer has the right information to make informed credit decisions and thus avoid or minimize losses. A trade credit insurance policy, therefore, does not replace but supplements a supplier's credit processes.

Unlike other types of business insurance, once a supplier purchases trade credit insurance, the policy does not get filed away until next year's renewal, but rather the relationship becomes dynamic. A trade credit insurance policy can change often over the course of the policy period, and the supplier's credit manager plays an active role in that process. Most trade credit insurers will individually analyze the supplier's larger buyers and assign each of them a specific credit limit. This is where the type and amount of information the insurer has on a buyer, or is provided by the supplier, plays a very important role in setting and monitoring the credit limits.

Throughout the life of the policy, the supplier may, for example, request additional coverage on an existing buyer. The trade credit insurer will investigate the risk of increasing the credit limit and will either approve the requested higher limit or decline with a written explanation. Similarly, suppliers may request coverage on a new buyer with whom they would like to do business.

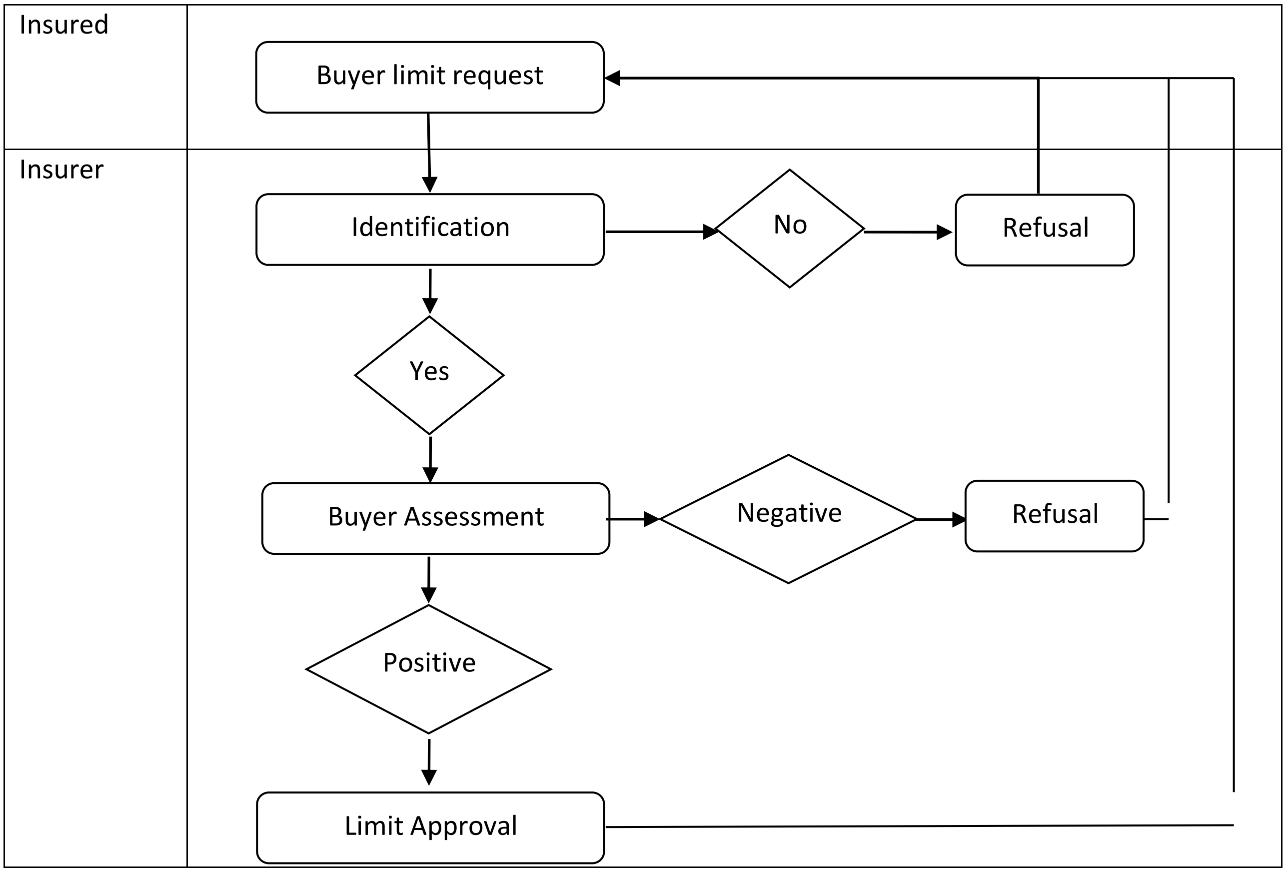
**1.6**

A process Note & Flow on Buyer Underwriting for better understanding: -

## Approach

Buyer underwriting forms a key aspect of Risk Management for trade credit insurance and is performed by the Risk Underwriting Team. This team functions within the defined boundaries of the Guidelines of the insurance company and should have a balanced approach to support the requirement of the Insured while maintaining responsibility towards the interest of the insurance company.

## Process Flow




## Buyer Identification

The first step is to establish the correct entity on which the limit is requested based on the information provided by the insured. In case the buyer is un-identifiable, the request is rejected, and correct information is sought from the insured.

## Buyer Assessment

The insurer may (but not restricted to) consider the below parameters while assessment of the buyer:

Quantitative Analysis- Financial parameters related to the buyer

- Scale of operation & trend analysis like Turnover, Profitability, Net Worth, Cash Flow
- Ratio Analysis like Profitability Ratio, Liquidity Ratio, Solvency Ratio, Activity Ratio
- External Credit Rating

Qualitative Analysis - Non-Financial parameters related to the buyer

- Constitution/ Legal Status
- Business vintage, management skills & group support
- Trading History with Insured, years of relationship and dependency
- Business activity & sector performance
- Past payment behavior or loss experience
- Adverse information or News in Public Domain

**Limit Approval**

Based on the assessment an internal Credit Rating is assigned and credit limit decision is taken. The insurer may approve the limit fully/ partially or refuse the limit. For a greater operational flexibility an insurer can fix a maximum permissible exposure amount (may be called Overall Limit, OL) on the buyer based on its creditworthiness assessment and the said exposure amount can be distributed among multiple policy holders in the form of Credit Limit(CL) suiting individual requirement. The insured during the policy period has the flexibility to request for modification of buyer limit or addition of fresh buyer.

**Limit Monitoring**

One of the critical aspects of the Buyer Underwriting process is continuous monitoring of the buyer portfolio. The exposure is monitored at buyer as well as on group level. In case of any claim or overdue reported on a buyer by any insured, the total limits under all policies are cancelled.

**1.7**

It is also the trade credit insurer's responsibility to proactively monitor its customers' buyers throughout the year to ensure their continued creditworthiness. This is achieved by gathering information about buyers from a variety of sources, including: visits to the buyer, public records, information provided by other suppliers that sell to the same buyer, receipt of the most recent financial statements, and so on. When it becomes knowledge that a buyer is or may be experiencing financial difficulty, the insurer notifies all suppliers that sell to that buyer of the increased risk and establishes an action plan to mitigate and avoid loss. The goal of a trade credit insurance policy is not to simply pay claims as they arise, but also to help suppliers avoid foreseeable losses. If an unforeseeable loss should occur, the indemnification aspect of the trade credit insurance policy comes into effect.

In these cases, the supplier would file a claim with the trade credit insurer, including the required supporting documentation, and after the expiry of the applicable waiting period, the trade credit insurer would pay the supplier the amount of the indemnified loss.

However, it should be understood that trade credit insurers do not cover losses where there is a valid dispute between the supplier and the buyer as to the quality of the goods and services provided, for example, where the goods are found to be damaged on delivery. For a supplier to have a valid claim against the insurer, it must have a valid and legally enforceable debt against the buyer that can be assigned to the insurer. Until the dispute has been finally settled in favor of the supplier it will not be considered an insured sale. In the case of insolvency this means that the supplier must obtain a written acknowledgement from the receiver that it has recognized and accepted the debt.

Trade credit insurance can be an excellent risk management tool for many companies, but it may not be applicable to the following types of suppliers:

- Retailers—Trade credit insurance only covers business-to business accounts receivable and not retail sales;
- Suppliers that sell to their group entities;
- Suppliers that sell exclusively to governments; and
- Suppliers that do not sell on open account terms.

For the most part, however, any supplier that conducts business-to-business trade transactions is essentially already investing in a trade credit insurance program. This investment is the sum of the costs associated with the supplier’s risk philosophy, sales avoided, systems, credit/financial information, accounts receivable management, losses incurred, collection and insolvency management. All these are real costs and should be weighed against the cost associated with outsourcing many of these functions to a competent trade credit insurer and the benefits the supplier would derive from such a relationship.

In the face of the global recessionary climate, increased business failures both domestically and globally, and the tightening of credit across the board, business suppliers must be ever more vigilant regarding the management of their accounts receivable. A trade credit insurance policy, if used properly, provides a valuable extension to a company’s credit management practices—a second pair of objective eyes when approving buyers, as well as an early warning system should things begin to decline so that existing exposure can be effectively managed. Not forgetting that should an unexpected loss occur, the trade credit insurance policy provides indemnification, thus protecting the policyholder’s revenues, profits, balance sheet and employees from what could otherwise be a financially catastrophic event. By maintaining a strong relationship between the insurer and the credit management department, trade credit insurance may be the wisest investment a company can make to ensure its profits, cash flow, capital and employment are protected.

## 1.8

## Alternative Products

Trade credit insurance competes both with bank letters of credit as well as factoring / invoice discounting. Table 1 below provides an overview of the two main products and their features.

### Letters of credit

A documentary letter of credit is a bank's agreement to guarantee the payment of a buyer's obligation up to a stated amount for a specified period. Unlike trade credit insurance, the buyer must approach the bank to request a letter of credit, which has the disadvantage of reducing the buyer's borrowing capacity as it is charged against the overall credit limit set by the bank. In developing markets, it may need to be cash secured. A letter of credit will only cover a single transaction for a single buyer whereas trade credit insurance usually covers all supplier's shipments to all of its buyers. As a letter of credit is for a single transaction for a single buyer, it is normally more expensive than trade credit insurance, both in terms of absolute cost and in terms of credit line usage with the additional need for security.

### Factoring

Receivables form a major part of the current assets of a company and management of such receivables is the most important concern for the company. Factoring is a financial option for the management of receivables. It is a tool to obtain quick access to short-term financing and mitigate risks related to payment delays and defaults by buyers. In the process of factoring, the seller sells its receivables to a financial institution ("Factor") at a discount. After the sale, there is an immediate transfer of ownership of the receivables to the factor. In the due course of time, either the factor or the company, depending upon the type of factoring, collects payments from the debtors.

Factoring is a traditional product that allows a supplier to pre-finance its receivables whereby the factor pays a percentage of the face value of the receivables based upon its assessment of the credit risk and the underlying payment terms. Consequently, it is more expensive than trade credit insurance. It may be either non-recourse factoring, or full recourse factoring whereby the factor will reclaim the money from the supplier if the buyer does not pay.

Trade credit insurance and factoring both complement and substitute for each other. Where full recourse factoring is used, then it is in the best interests of both the supplier and the factor for the supplier to purchase trade credit insurance, and where it is non-recourse factoring then the factor may itself purchase trade credit insurance to protect themselves against non-payment by the buyer.

Table 1: Trade credit insurance and its substitutes

| Feature | Credit insurance | Letter of Credit | Factoring without recourse |
|---|---|---|---|
| Risk Cover | Insolvency, protracted default and political risks | Buyer default | Insolvency and protracted default |
| Ancillary Services | Credit information, risk assessment, market intelligence, debt collection | None | Debt collection and credit information |

| | | | |
|---|---|---|---|
| Financing | None, but facilitates financing | None | Converts trade receivables into cash at a discount |
| Client relations | Buyer is unaware of credit insurance contract | Buyer initiates provision of letter of credit | Collection by factor of trade receivables may affect client relations |

**Sources: -**


- Trade Credit Insurance by Peter M Jones- http://siteresources.worldbank.org/FINANCIALSECTOR/Resources/Primer15_TradeCreditInsurance_Final.pdf

# CHAPTER – 2

## Credit Insurance Landscape – Global & India

### 2.1

### Credit Insurance Landscape – Global

The market for credit insurance globally has been segmented based on components into two major segment including products and services. The companies operating in the global credit insurance market design and innovate robust products and services depending upon the requirements of the customers or clients.

The global credit insurance market is further bifurcated on basis of enterprise size as small & medium enterprises (SMEs) and large enterprises. The large enterprises capture a significant market share in the global credit insurance market over the years. The different types of applications of credit insurance includes domestic trading market and export trading market. The export segment in the application is much more prominent and the demand for credit insurance products and services are gaining importance in the domestic market in the current years.

The global market for credit insurance is categorized on basis of five strategic regions namely; North America, Europe, Asia Pacific, Middle East and Africa, and South America. Geographically, the two most dominant region in the current market scenario accounted for Europe and North America.

With the increase in small & medium trading enterprises across the globe, the market for credit insurance market is expected to be fuelled by the SMEs segment. The small and medium business enterprises across the globe frequently encounters related to its account receivables according to the plans made while exporting or trading in domestic and international market. The non-payment of invoices effects the bottom line of these small and medium enterprises. This risk is constantly growing across geographies and the enterprises are looking for robust solutions to get rid of the threat. This is the reason behind rising attraction towards credit insurance among the small and medium enterprises in developed countries and few developing countries.

The global market for credit insurance is expected to exhibit high growth in near future. Some of the major driving factors contributing to the market growth includes the global macro-economic instability, which is posing a severe commercial threat to the trader, thereby, increasing the adoption of credit insurance.

However, the growth of global market for credit insurance accounted for several fraudulent cases related to insurance claims from both the policyholders as well as the insurance underwriters. These fraudulent cases have restricted the adoption of the credit insurance sector among the small and medium enterprises (SMEs) in the developing economies across the globe.

Nonetheless, economically stable countries in Asia Pacific region such as China, India, Singapore, Australia, and Malaysia among others pose a substantial market opportunity in the coming years.

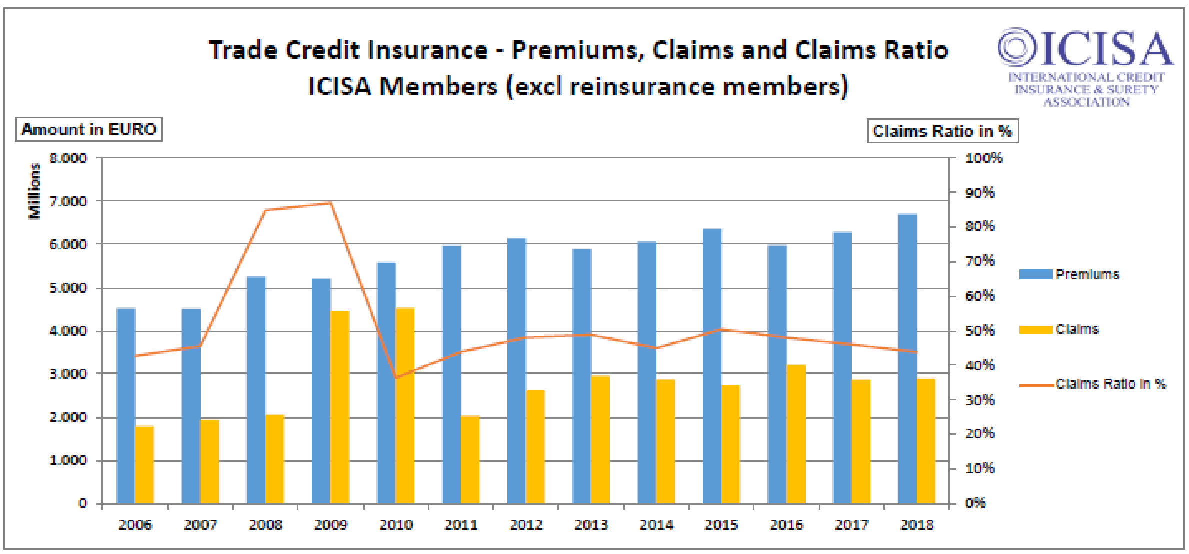
**2.2**

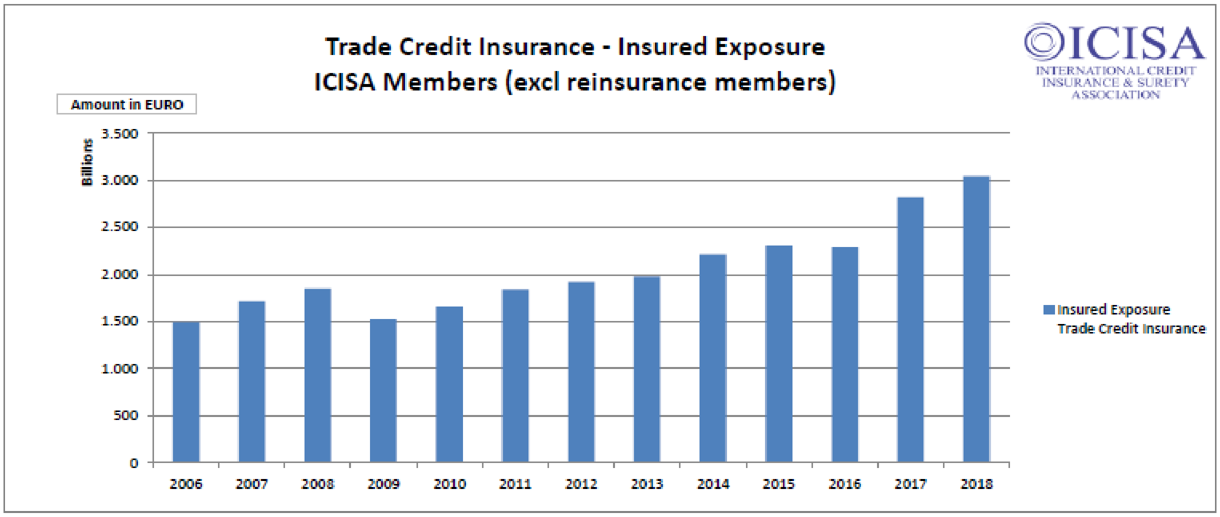
There are largely two global association (ICISA & Berne Union) where Trade Credit Insurers & Reinsurers as members keep publishing their data related to the business done, claims & their exposure on the markets. This data gives us a deep insight on how Trade Credit Insurers help businesses by protecting the risk arising form failure of being paid.

ICISA (International Credit Insurance & Surety Association) has a mix of both private players & the ECAs (Export Credit Agencies).

Berne Union has more ECAs & reinsurers as their members.

Please note that short term trade credit (ST), dominates the statistics, accounting for 90% of total new business underwritten. Medium / Long-term (MLT) export credit insurance accounts for 8% and investment insurance just 2%

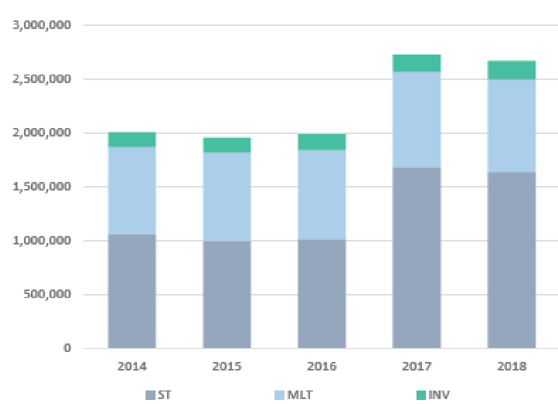




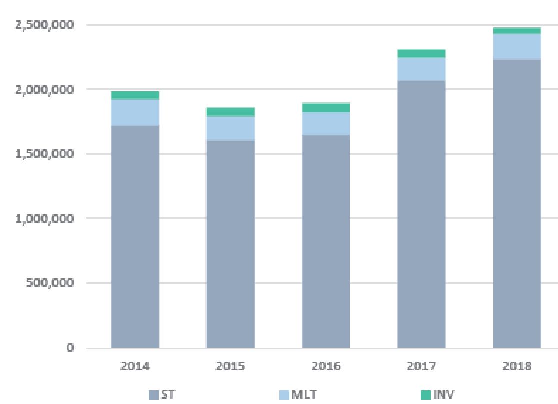

# Berne Union Totals

Note: all figures in USD millions, unless otherwise stated.

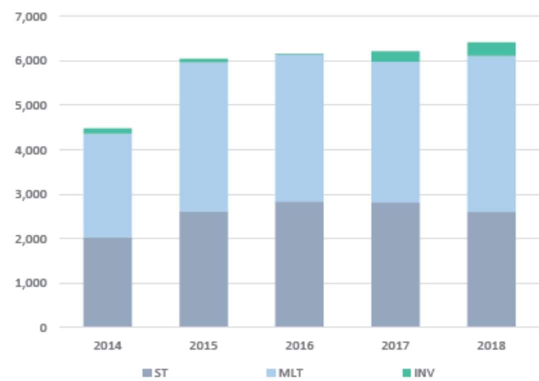
### Total exposure at end of year



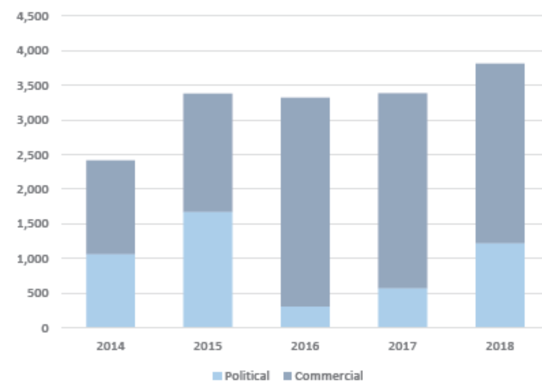

### New commitments during each year



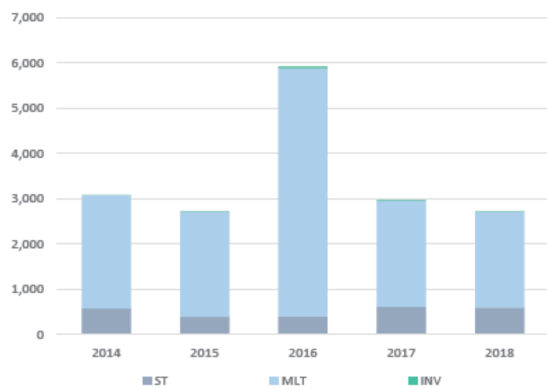
## Claims paid during each year



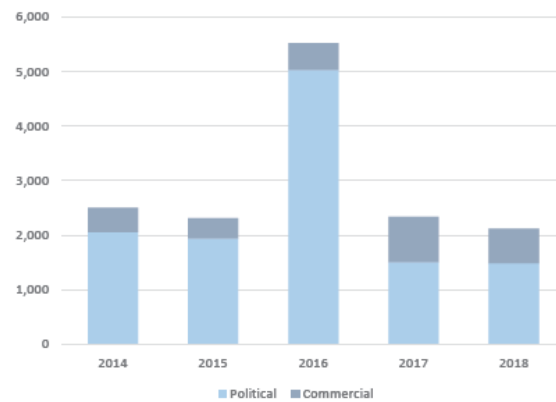

## Political share of non-ST claims



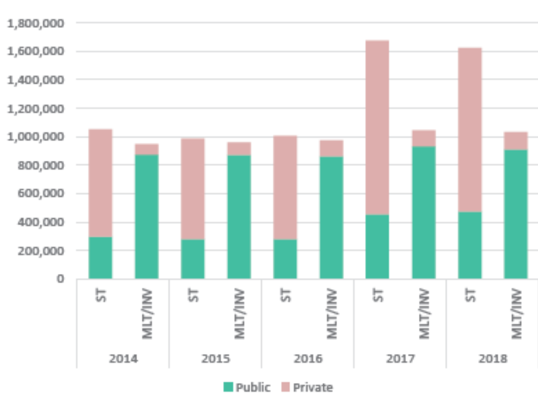

## Recoveries during each year



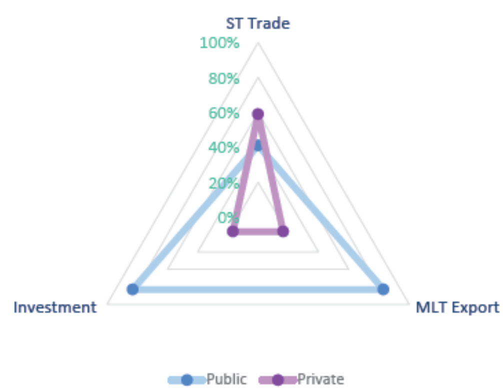

## Political share of non-ST recoveries



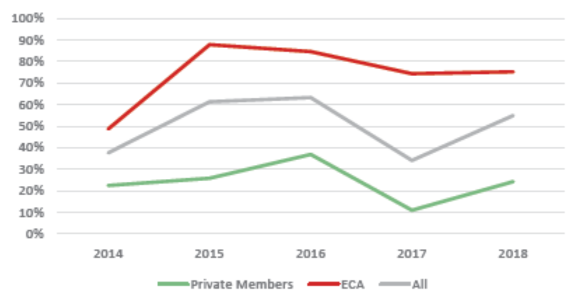

## Public and private share of total exposure



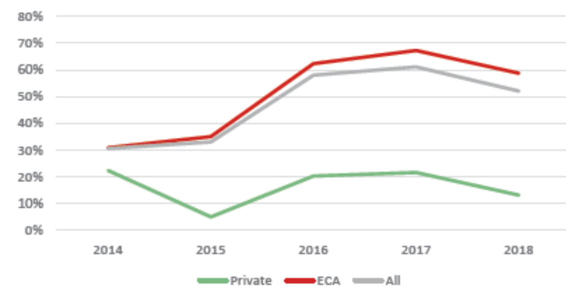

## Public and private share of new commitments



### ST loss ratio by provider

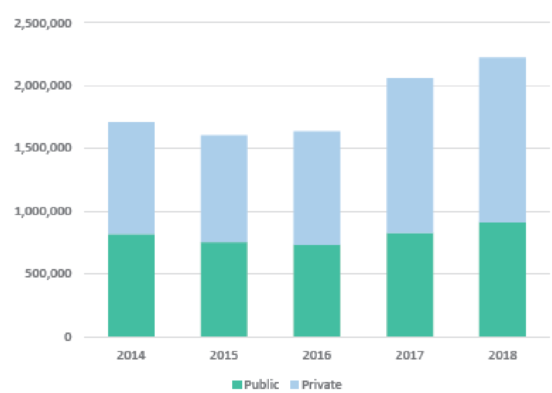



### MLT loss ratio by provider

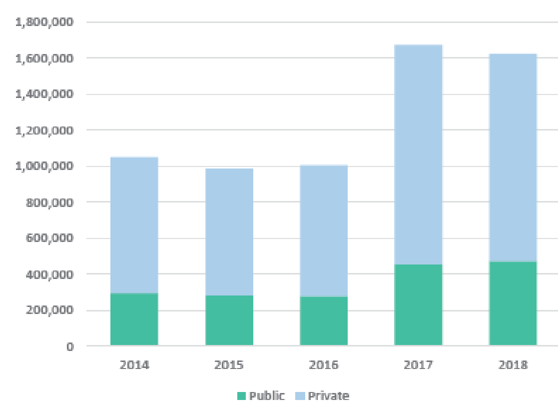



# Short-Term Export Credit Insurance

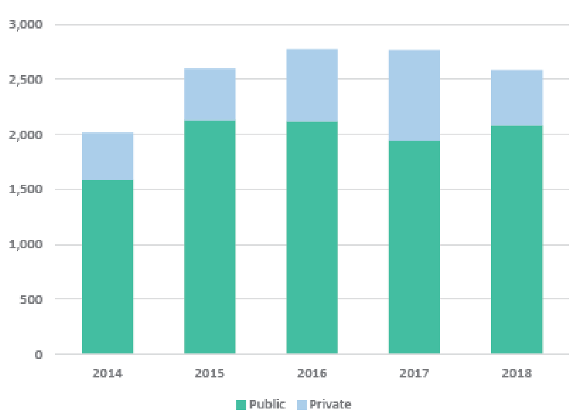
### ST turnover covered during each year



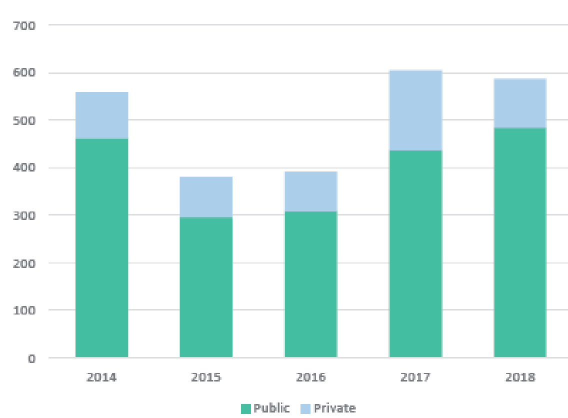

### ST commitments at year end



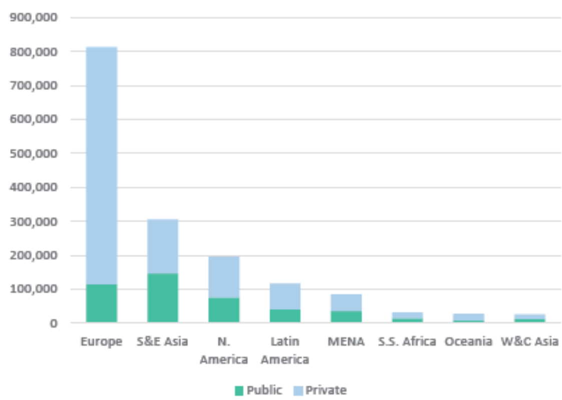

### ST claims paid during each year



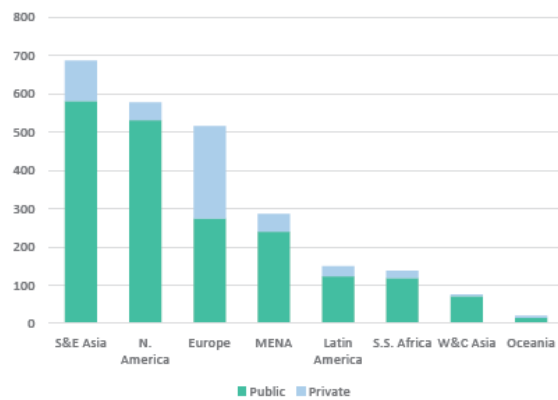

### ST recoveries during each year



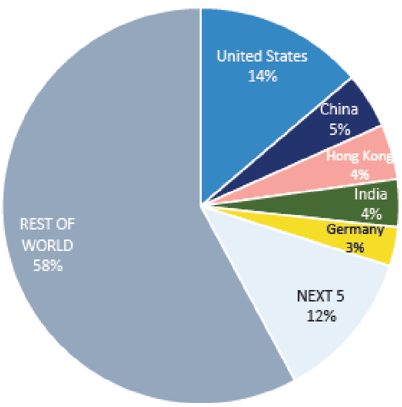
## Regional share of ST commitments 2018 YE



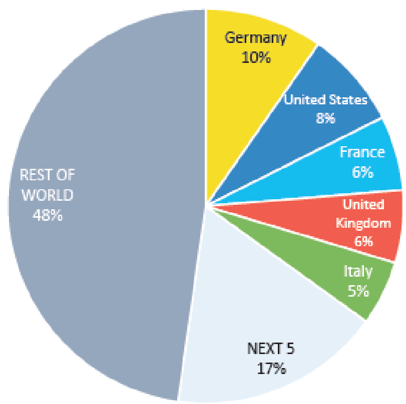

## Regional share of ST claims paid 2018



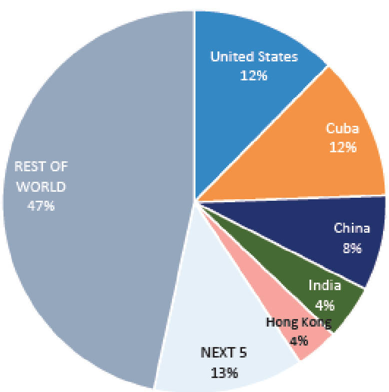

## Top countries public commitments 2018



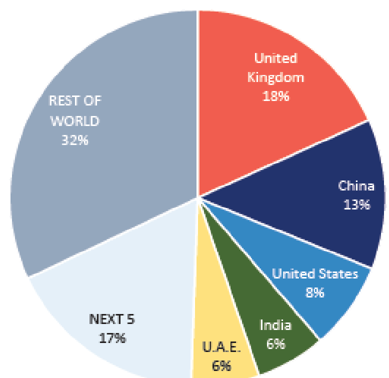

## Top countries private commitments 2018




## Top countries public claims 2018




## Top countries private claims 2018



## 2.3

There are instances where Governments are trying to support business with Credit Insurance as well as worked to tweak regulations a bit to maintain the overall governance of Credit Insurance Sector as well.

**SINGAPORE GOVERNMENT SUPPORT:**

There are 2 schemes under which the Govt of Singapore supports SME sector to help them absorb part of premium paid.

**1). Trade Credit Insurance Scheme (TCIS)**

The Trade Credit Insurance Scheme (TCIS) defrays the cost of insurance for companies by supporting part of the minimum premium payable.

Benefit

If your company qualifies, Enterprise Singapore can support up to 50% of the minimum insurance premium for TCI policies provided commercially by Singapore-registered credit insurers. This is subject to a maximum lifetime support of S$100,000 per qualifying Applicant Company.

**2). Political Risk Insurance Scheme (PRIS)**

Political risks insurance (PRI) is an important tool for companies to safeguard their projects and/or investments in overseas markets against political uncertainties.

Companies can also use PRI to unlock access to mid to long-term financing as it gives lenders additional assurance that the impact of political uncertainties over the performance of a project or investment has been mitigated.

With Political Risk Insurance Scheme (PRIS), qualifying Singapore companies can receive premium support for PRI policies. Enterprise Singapore will support 50% of the premium for up to the first three years of each PRI policy. This is subject to a maximum amount of S$500,000 per qualifying Singapore-based company.

## 2.4

## CHINA REGULATIONS ON CREDIT INSURANCE:

China Banking & Insurance Regulatory Commission ("CBIRC") issued on 11 July 2017 new 'Regulations Governing Credit Insurance Business' (the "Regulations") in order to strengthen macro governance of the Credit Insurance sector.

The Regulations now require that in order to write Credit Insurance business, China insurers must:

- ensure that at any given time, their gross retained liability/exposure to Credit Insurance risk does not exceed ten times such insurer's net asset value, as measured at the end of the previous quarter, with any retained exposure in excess of this amount to be reinsured off such insurer's books;

- ensure that the retained exposure to any single Credit Insurance insured (singly or as an affiliated group) does not exceed 5% of such insurer's net asset value, as measured at the end of the previous quarter, with any retained exposure in excess of this amount to be reinsured off such insurer's books; and

- not offer or underwrite Credit Insurance for any online lending platform operator, unless such online lending platform operator is duly licensed and fully compliant with all online lending regulations.

## 2.5

## Credit Insurance Landscape – India

Credit Insurance in India started way back in 1957 when Government of India decided to setup the Indian ECA (ECGC) to promote Exports from our country supporting the business & Economy.

Post that when the Insurance Sector was opened in 1999 after IRDA was created, lot of public as well as private players are doing this business regularly though the business is slowly picking up compared to other lines of Insurance Business.

**Players in Indian Market: -**

ECGC: ECGC Ltd. (Formerly Export Credit Guarantee Corporation of India Ltd.), wholly owned by Government of India, was set up in 1957 with the objective of promoting exports from the country by providing Credit Risk Insurance and related services for exports. It functions under the administrative control of Ministry of Commerce & Industry and is managed by a Board of Directors comprising representatives of the Government, Reserve Bank of India, banking, and insurance and exporting community. Over the years it has designed different export credit risk insurance products to suit the requirements of Indian exporters and commercial banks extending export credit.

ECGC is essentially an export promotion organization, seeking to improve the competitiveness of the Indian exporters by providing them with credit insurance covers. ECGC keeps its premium rates at the optimal level.

NEW INDIA: Though ECGC was offering Credit Insurance to exporters to cover their sales since 1957, there was no product available in India to cover domestic sales. The New India Assurance Co. Ltd introduced domestic Credit Insurance in India, vide their product "Business Credit Shield" in September 2001. Though the product was approved by IRDAI in May 2001, it was formally inaugurated by then Finance Minister Mr. Yeshwant Sinha in Sept 2001.

Other Players: -

- SBI GIC
- IffcoTokioGIC
- Tata AIG GIC
- ICICI Lombard GIC
- HDFC ERGO GIC
- Bajaj ALLIANZ GIC
- Bharti AXA GIC
- Universal Sompo GIC
- Future Generali GIC
- United India
- National Insurance

**2.6**

Total INDIA Premium: -

| **Credit Insurance Premium incl ECGC** (Source: IRDAI) | |
|---|---|
| | |
| **Year** | **Premium in Cr** |
| | |
| **2018-19** | **1525.21** |
| **2017-18** | **1476.98** |
| **2016-17** | **1467.90** |

**Premium player Wise**

| "Credit" LoB GDP (Source: IRDAI) | | | | |
|---|---|---|---|---|
| | | | | in Rs Crores |
| S. No | **Insurer** | **2016-17** | **2017-18** | **2018-19** |
| 1 | ECGC | 1267.61 | 1240.41 | 1247.54 |
| 2 | ITGI | 73.20 | 72.69 | 86.31 |
| 3 | ICICI Lombard | 33.57 | 44.01 | 41.13 |
| 4 | Tata Aig | 25.68 | 32.71 | 42.15 |
| 5 | Bajaj Allianz | 16.26 | 13.85 | 10.68 |
| 6 | SBI GIC | 9.32 | 13.02 | 18.84 |
| 7 | New India | 32.27 | 36.96 | 42.11 |
| 8 | HDFC Ergo | 6.05 | 19.19 | 31.65 |
| 9 | Bharti Axa | 2.96 | 3.12 | 2.91 |
| 10 | Raheja QBE | 0.76 | 1.02 | 1.90 |
| 11 | Universal Sompo | 0.21 | 0.00 | 0.00 |
| 12 | UIIC | 0.00 | 0.00 | 0.00 |
| | Grand Total | **1467.9** | **1476.99** | **1525.22** |

| "Credit" LoB GDP excluding ECGC | | | | |
|---|---|---|---|---|
| | | | | in Rs Crores |
| S. No | **Insurer** | **2016-17** | **2017-18** | **2018-19** |
| | | | | |
| 1 | ITGI | 73.20 | 72.69 | 86.31 |
| 2 | ICICI Lombard | 33.57 | 44.01 | 41.13 |
| 3 | Tata Aig | 25.68 | 32.71 | 42.15 |

| | | | | |
|---|---|---|---|---|
| 4 | Bajaj Allianz | 16.26 | 13.85 | 10.68 |
| 5 | SBI GIC | 9.32 | 13.02 | 18.84 |
| 6 | New India | 32.27 | 36.96 | 42.11 |
| 7 | HDFC Ergo | 6.05 | 19.19 | 31.65 |
| 8 | Bharti Axa | 2.96 | 3.12 | 2.91 |
| 9 | Raheja QBE | 0.76 | 1.02 | 1.90 |
| 10 | Universal Sompo | 0.21 | 0.00 | 0.00 |
| 11 | UIIC | 0.00 | 0.00 | 0.00 |
| | Grand Total | **200.29** | **236.58** | **277.68** |

**2.7**

The genesis of the inherent contradiction can be traced back to the first set of guidelines on trade credit insurance released in December 2010 (IRDA/NL/PR/CRE/208/12/2010). The Authority at that time, concerned and alarmed with global crisis, economic slowdown, looming claims, widespread mis-selling & frauds stop the product in the existing framework & relaunch it with stringent guidelines. These guidelines were applicable to all insurance companies doing Credit Insurance Business except ECGC.

The key guidelines were: -

- Policy cannot be issued to Banks / FIs
- No Assignment of Policies
- No factoring / Bill discounting or similar arrangement to be covered.
- Only whole turnover policies
- No Single Buyer Policy
- Indemnity at 80%
- All buyers contributing more than 2% of the total turnover to be compulsory assessed.
- No govt or para govt buyers to be covered

In 2016 (IRDA/NL/CIR/CRE/044/03/2016), IRDA revisited the guidelines to provide relief to the industry. The major changes were: -

- Assignment of proceeds of the claim was permitted
- Flexibility in whole turnover in terms of Segment/Country permitted
- Indemnity increased to 85%
- The cap on min number of 10 buyers was lifted.

There were still further gaps which were required to be addressed. Between 2016 – 2019, various industry bodies like Banks, Factoring Companies, Trade Associations, Insurers & Brokers represented their wishes to the regulator to ensure maximum utilization of the product at par with Global Standards for the benefit of the policy holders.

In today's context, effective norms have been framed in the area of AML & KYC. Also, Government of India has prepared the ground for the next generation reforms in banking and supporting Indian business, with strong focus on SMEs and MSMEs. The passage of various acts like

- Factoring Regulations act 2011
- RBI regulations 2013 to allow a special category as NBFC-Factors
- Specific guidelines from Regulators with/without Recourse Factoring – 2014,2015,2016
- Formation of Credit Guarantee Fund (NCGTC) 2014 budget (which is under implementation by Ministry of Finance and SIDBI
- Creation of TReDS (Trade receivables Discounting Exchange) 2015-16
- Insolvency and Bankruptcy Code (IBC), 2016
- Implementation of E-way bills and proposed e-invoicing system will reduce domestic trade malpractices in large extend

- Automated process of cautioning / de-cautioning of exporters through EDPMS system will arrest malpractices in export business
- Availability of robust credit bureaus information’s

With the above reforms, including a unified tax structure by way of the goods and service Tax, paves way for a conducive business environment for SMEs and MSME’s.

## Chapter – 3

## Factoring

**3.1**

The Factoring Act, 2011 defines the 'Factoring Business' as "the business of acquisition of receivables of assignor by accepting assignment of such receivables or financing, whether by way of making loans or advances or in any other manner against the security interest over any receivables". However, credit facilities provided by banks in the ordinary course of business against security of receivables and any activity undertaken as an agent or otherwise for sale of agricultural produce or goods of any kind whatsoever and related activities are expressly excluded from the definition of Factoring Business. The Factoring Act has laid the basic legal framework for factoring in India.

NBFC-Factor means a non-banking financial company fulfilling the Principal business criteria i.e. whose financial assets in the factoring business constitute at least 75 percent of its total assets and income derived from factoring business is not less than 75 percent of its gross income, has Net Owned Funds of Rs. 5 crore and has been granted a certificate of registration by RBI under section 3 of the Factoring Regulation Act, 2011.

Every company registered under Section 3 of the Companies Act 1956 seeking registration as NBFC-Factor shall have a minimum Net Owned Fund (NOF) of Rs. 5 crore. Existing companies seeking registration as NBFC-Factor but do not fulfil the NOF criterion of Rs. 5 crore may approach the Bank for time to comply with the requirement.

A company shall have to submit to RBI, a letter of its intention either to become a Factor or to unwind the business totally, and a road map to this effect. The company would be granted CoR as NBFC-Factor only after it complies with the twin criteria of financial assets and income. If the company does not comply within the period as specified by the Bank, it would have to unwind the factoring business.

An entity not registered with the Bank may not conduct the business of factoring unless it is an entity mentioned in Section 5 of the Act i.e. a bank or any corporation established under an Act of Parliament or State Legislature, or a Government Company as defined under section 617 of the Companies Act, 1956.

Under Section 19 of the Factoring Act, 2011 every Factor is under obligation to file the particulars of every transaction of assignment of receivables in his favour with the Central Registry to be set-up under section 20 of the Securitization and Reconstruction of Financial Assets and Enforcement of Security Interest Act, 2002 (54 of 2002), within a period of thirty days from the date of such assignment or from the date of establishment of such registry, as the case may be.

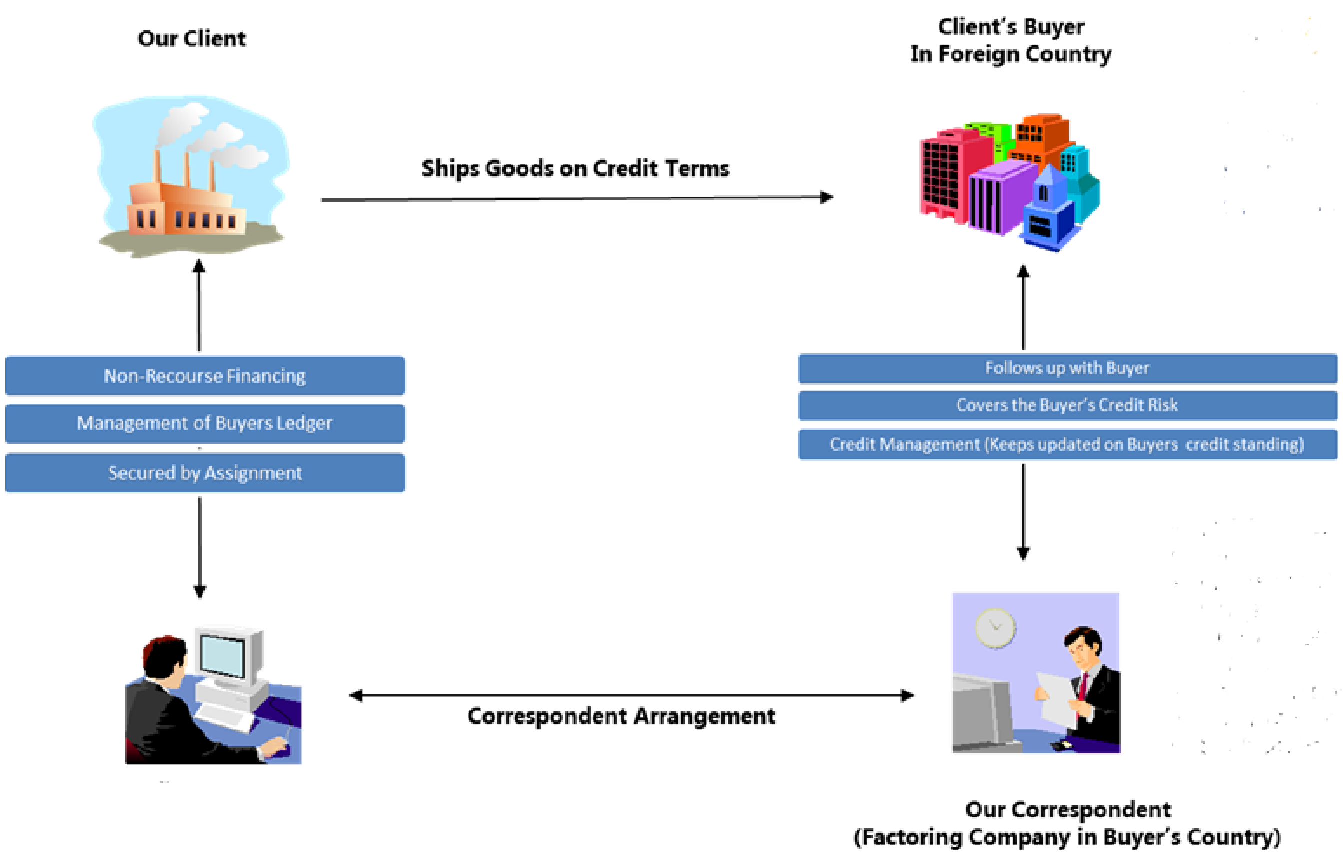
NBFC-Factors undertaking import & export factoring will need to obtain the necessary authorization from the Foreign Exchange Department of the Bank under FEMA 1999 as amended and adhere to all the FEMA regulations in this regard.

**3.2**

Export Factoring: - Export factoring is a financing solution available to the exporter which allows the exporter to offer open account terms, a better liquidity position and allows it to be increasingly competitive. It can also be viewed as an alternative to export credit insurance, long-term bank financing or other high cost debt.

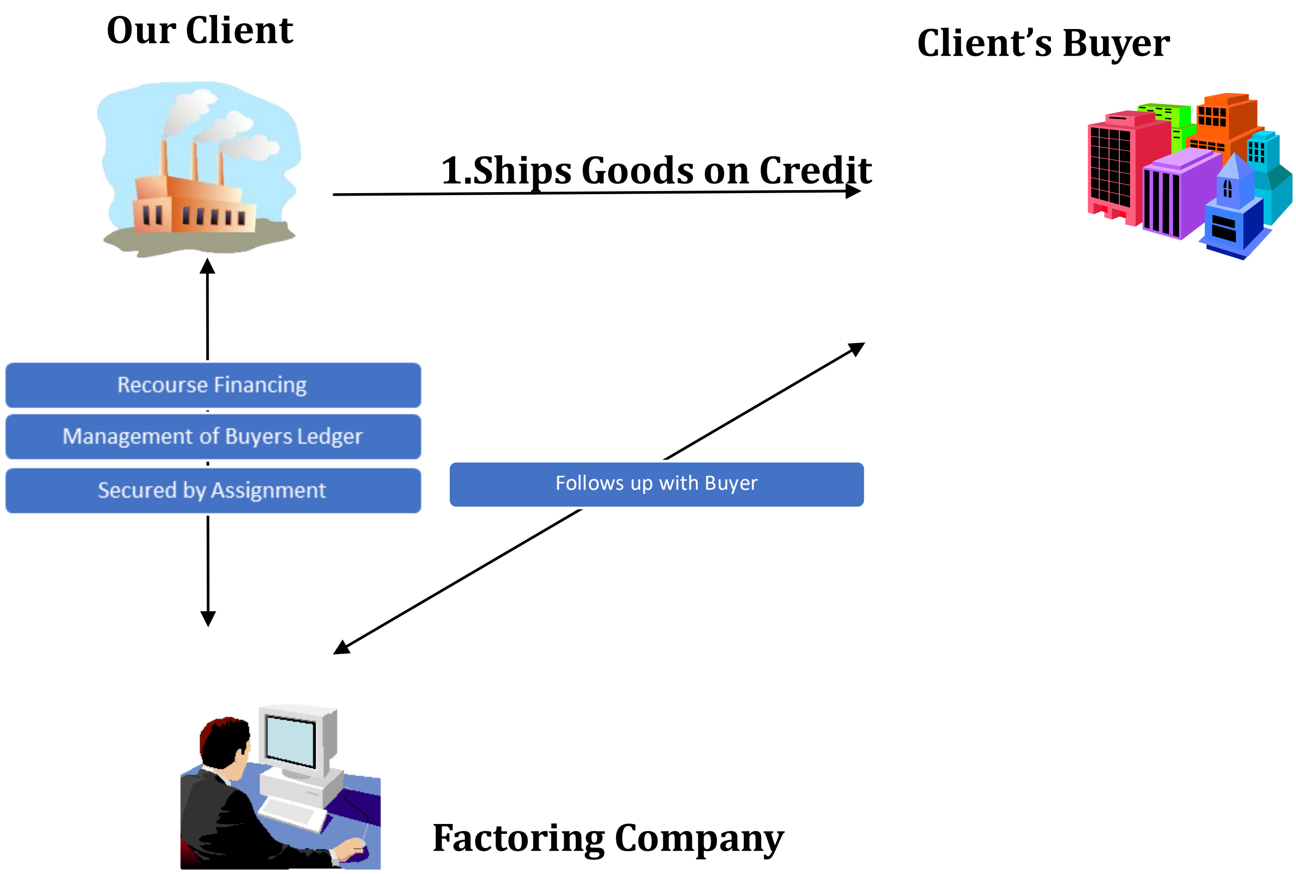
Export factoring allows trade to be carried out on open account terms and assists especially where there are short-term sales of products and where there may be risk of non-payment. It eases the credit and collection troubles in case of international sales and accelerates cashflows thereby assisting in credit risk mitigation and provides liquidity in the business.

Export factoring bundles together credit protection, export working capital financing, foreign accounts receivables bookkeeping and collection services- all in one product. It is the sale of foreign accounts receivable by a seller (exporter) to a factoring company at a discount, where the financier (factor) assumes the risk of default of the foreign buyer and handles collection on the receivables. The factor will purchase the accounts receivables or invoices, which are raised once the exporter ships the goods to the buyer (importer). Export financing is usually without recourse wherein the financier takes the payment risk of the importer.



**3.3**

Domestic Factoring: - Domestic Factoring is a process of factoring of accounts receivables generated out of sales within India. The Seller assigns to the Factor the accounts receivables arising out of sales to buyers within the country on open account terms and receives payment there against to the extent of 80-90% from the Factor, depending upon the credit terms.




Steps in Domestic Factoring:

1. Customer ( Buyer) places the order with Client (Seller)
2. Client (Seller) obtains a prepayment limit from Factoring Company
3. Client (Seller) delivers goods/services to the customer (Buyer).

4. Copies of Invoices, along with a Notice to Pay, are submitted to the FactoringCompany.
5. Factoring Company makes a prepayment advance to the Client
6. Factoring Company follows up on payment with the Customer (Buyer)
7. Customer (Buyer) makes payment to Factoring Company
8. Factoring Company makes the balance payment to the Client (Seller), net of charges.

**3.4**

**India Export Market Size: -**



FY'19 India exports were USD 330 Bn. The open account opportunity is approx USD 70 Bn. Further clasiification country & product wise as classified in the chart.

### 3.5 Factoring & International Markets (FCI)

Factoring and Bill discounting started in early 19th Century, now have more than 100 years of expertise in domestic and export Receivables Insurance and financing.

Globally Factoring volumes have crossed ~2300 Bn Euro and this availability and penetration have contributed immensely to GDP growth for their respective countries.

FCI (Factors Chain International) is the Global Representative Body for Factoring and Financing of Open Account Domestic and International Trade Receivables. With close to 400 member companies in 90 countries FCI offers a unique network for cooperation in cross-border factoring.

In the members of FCI, Specialist Trade Credit Insurers like Euler Hermes are also there supporting these Factoring companies with their knowledge to know more the buyers & further protect them for any default of the same.

Factoring companies with the support of Credit Insurers do help small business survive in terms of protection & availablity of financing to steer in their growth which finally helps the overall economy.

The following data & charts are published figures of FCI members on their Factoring Business Turnover.

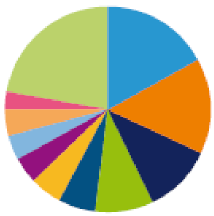
## FCI Members Accumulative Factoring Turnover vs Worldwide Factoring Turnover in million EURO in 2018: -

**Accumulative Turnover Figures for All FCI Members Compared to Worldwide Factoring Turnover** — in millions of Euros

| | 2011 | 2012 | 2013 | 2014 | 2015 | 2016 | 2017 | 2018 | Variation 2017/2018 |
|---|---|---|---|---|---|---|---|---|---|
| Invoice Discounting | 279,113 | 302,030 | 330,518 | 299,930 | 310,313 | 333,544 | 303,272 | 266,606 | -12% |
| Recourse Factoring | 267,523 | 306,187 | 339,644 | 356,058 | 301,948 | 236,613 | 231,270 | 245,583 | 6% |
| Non-Recourse Factoring | 331,257 | 352,353 | 344,863 | 372,115 | 434,456 | 481,172 | 478,640 | 482,885 | 1% |
| Collections | 26,018 | 27,786 | 31,399 | 40,123 | 57,725 | 47,472 | 40,866 | 57,185 | 40% |
| Reverse | | | | | | | 50,010 | 89,482 | 79% |
| **Total Domestic Factoring FCI** | **903,912** | **988,529** | **1,046,425** | **1,068,226** | **1,104,441** | **1,098,800** | **1,104,058** | **1,141,741** | 3% |
| Export Factoring | 162,972 | 192,573 | 219,285 | 242,472 | 261,214 | 256,551 | 292,408 | 211,195 | -28% |
| Import Factoring | 30,943 | 36,707 | 50,481 | 54,081 | 66,612 | 63,446 | 55,460 | 31,719 | -43% |
| Export Invoice Discounting | 51,069 | 85,163 | 87,447 | 89,025 | 96,871 | 108,038 | 106,104 | 59,569 | -44% |
| Reverse | | | | | | | 4,497 | 7,638 | 70% |
| **Total International Factoring FCI** | **244,983** | **314,442** | **357,213** | **385,579** | **424,697** | **428,035** | **458,469** | **310,120** | -32% |
| **Grand Total FCI** | **1,148,895** | **1,302,971** | **1,403,638** | **1,453,804** | **1,529,138** | **1,526,836** | **1,562,527** | **1,451,861** | -7% |
| World Domestic Factoring | 1,750,899 | 1,779,785 | 1,827,680 | 1,857,410 | 1,838,366 | 1,868,855 | 2,078,758 | 2,244,214 | 8% |
| World International Factoring | 264,108 | 352,446 | 402,798 | 490,114 | 529,379 | 507,112 | 519,540 | 522,852 | 1% |
| **World Total** | **2,015,007** | **2,132,231** | **2,230,477** | **2,347,524** | **2,367,745** | **2,375,967** | **2,598,298** | **2,767,067** | 6% |

# FCI Members Domestic, International, Factoring & International Volume Data

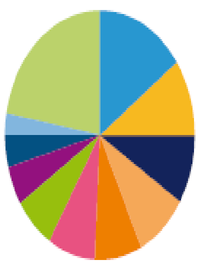
## Share of 2018 FCI Factoring Volume



| | | | |
|---|---|---|---|
| China | 17% | United States | 4% |
| Italy | 15% | Japan | 4% |
| France | 11% | Russia | 4% |
| Spain | 9% | Taiwan | 3% |
| United Kingdom | 6% | Rest | 22% |
| Germany | 5% | | |

The volume of the "Top Ten" FCI Members' countries/Territories accounts for to 78% of the total, China leading the way with 17% followed by Italy (15%) France (11%), Spain (9%), UK with 6%, Germany 5%, US, Japan and Russia (4%) and Taiwan (3%).

## Share of 2018 FCI International Factoring Volume

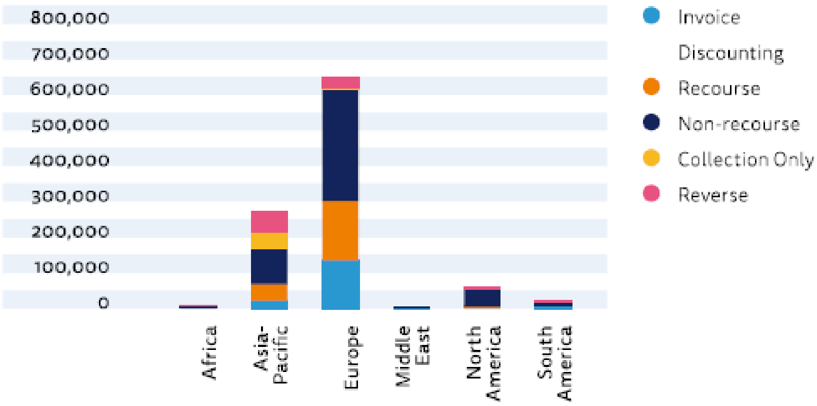


| | | | |
|---|---|---|---|
| Italy | 15% | The Netherlands | 7% |
| Taiwan | 10% | Belgium | 5% |
| Germany | 9% | France | 4% |
| Singapore | 9% | United Kingdom | 3% |
| China | 8% | Rest | 22% |
| Spain | 8% | | |

When breaking down the volumes of FCI Members' Countries/Territories International Factoring volume, we find the "Top Ten" adding up to 78% and find Italy in first position with 15%, followed by Taiwan (10%), Germany and Singapore (9%) China and Spain (8%), The Netherlands (7%) Belgium (5%), France (4%) and UK (3%).

FCI Members Domestic Volume 2018

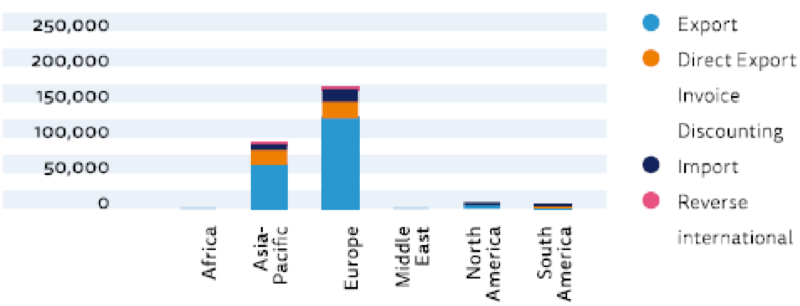
in millions of Euros




All Continents contribution to the FCI Members' Domestic volume shows Europe at the top by far. Here the Non-Recourse volume has grown to 40%, Recourse to 23% whilst Invoice Discounting shows a small decrease to 22%.

FCI Members International Volume 2018

in millions of Euros




When breaking down the FCI Members International volumes by continent, Europe, reaching 61% gained the leading position, replacing Asia Pacific (34%). The Americas together accounted for over 5% whilst Afrca and Middle East together represented less than 1%.

**Factoring Turnover by Country in 2018 in Millions of Euros: -**

Please find the details of the factoring turnover by each country as mentioned in FCI report 2018. The Indian Factoring Market is miniscule in terms of the economy size vis-à-vis compared to even similar economies.

Globally Factoring companies take the support of Credit Insurance to increase their support in lending to businesses thus extedning the credit line for SMEs.

| Country | Domestic | International | Total | Companies |
|---|---|---|---|---|
| Egypt | 428 | 89 | 517 | 9 |
| Mauritius | 224 | 3 | 227 | 3 |
| Morocco | 2,424 | 108 | 2,532 | 6 |
| South Africa | 18,532 | 50 | 18,582 | 13 |
| Tunisia | 299 | 17 | 316 | 5 |
| **Africa Total** | **21,907** | **267** | **22,174** | **36** |
| | | | | |
| Australia | 54,319 | 11 | 54,330 | 6 |
| China | 371,784 | 39,789 | 411,573 | 31 |
| Hong Kong | 13,500 | 40,000 | 53,500 | 17 |
| India | 4,000 | 532 | 4,532 | 10 |
| Japan | 42,135 | 7,213 | 49,348 | 3 |
| Korea | 16,413 | 9,232 | 25,645 | 166 |
| Malaysia | 4,387 | 72 | 4,459 | 25 |
| Singapore | 25,300 | 18,700 | 44,000 | 18 |
| Taiwan | 13,384 | 27,814 | 41,198 | 19 |
| Thailand | 5,877 | | 5,877 | 6 |
| Vietnam | – | 1,100 | 1,100 | 15 |
| **Asia-Pacific Total** | **551,098** | **144,463** | **695,562** | **166** |
| | | | | |
| Israel | 2,413 | 252 | 2,665 | 10 |
| Lebanon | 554 | 121 | 675 | 3 |
| UAE | 4,000 | 1,500 | 5,500 | 6 |
| **Middle East Total** | **6,967** | **1,873** | **8,840** | **19** |
| | | | | |
| Canada | 1,801 | 479 | 2,280 | 78 |
| USA | 72,100 | 15,721 | 87,821 | 700 |
| **North America Total** | **73,901** | **16,200** | **90,101** | **778** |

| | | | | |
|---|---|---|---|---|
| Armenia | 55 | 80 | 135 | 7 |
| Austria | 17,357 | 6,750 | 24,107 | 4 |
| Belarus | 266 | 114 | 380 | 15 |
| Belgium | 76,310 | 30 | 76,340 | 5 |
| Bulgaria | 2,143 | 1,068 | 3,211 | 9 |
| Croatia | 1,036 | 58 | 1,094 | 9 |
| Cyprus | 3,540 | 45 | 3,585 | 3 |
| Czech Republic | 4,399 | 2,379 | 6,778 | 6 |
| Denmark | 10,186 | 8,451 | 18,637 | 9 |
| Estonia | 2,988 | 612 | 3,600 | 6 |
| Finland | 23,500 | 2,300 | 25,800 | 5 |
| France | 223,752 | 96,657 | 320,409 | 13 |
| Georgia | 26 | 2 | 28 | 3 |
| Germany | 167,000 | 77,300 | 244,300 | 183 |
| Greece | 12,483 | 2,152 | 14,635 | 7 |
| Hungary | 6,514 | 397 | 6,911 | 15 |
| Ireland | 24,716 | 1,578 | 26,294 | 5 |
| Italy | 188,764 | 58,666 | 247,430 | 30 |
| Latvia | 390 | 394 | 784 | 6 |
| Lithuania | 1,500 | 2,160 | 3,660 | 9 |
| Luxembourg | 339 | – | 339 | 1 |
| Malta | 358 | 196 | 554 | 3 |
| Moldova | – | 4 | 4 | 1 |
| Netherlands | 78,694 | 19,674 | 98,368 | 5 |
| Norway | 23,167 | 2,756 | 25,923 | 4 |
| Poland | 46,645 | 9,829 | 56,474 | 24 |
| Portugal | 24,295 | 7,462 | 31,757 | 13 |
| Romania | 4,078 | 929 | 5,007 | 19 |
| Russia | 43,543 | 297 | 43,840 | 68 |
| Serbia | 585 | 65 | 650 | 21 |
| Slovakia | 1,601 | 920 | 2,521 | 8 |
| Slovenia | 930 | 470 | 1,400 | 15 |
| Spain | 146,963 | 19,428 | 166,391 | 20 |
| Sweden | 19,227 | 595 | 19,822 | 15 |
| Switzerland | 495 | 98 | 593 | 5 |
| Turkey | 22,411 | 4,483 | 26,894 | 82 |
| Ukraine | 244 | 1 | 245 | 19 |
| UK | 292,222 | 27,971 | 320,193 | 95 |
| **Europe Total** | **1,472,772** | **356,370** | **1,829,142** | **767** |
| | | | | |
| Argentina | 3,052 | 12 | 3,064 | 5 |
| Brazil | 47,208 | 73 | 47,281 | 600 |
| Chile | 23,900 | 2,600 | 26,500 | 150 |
| Colombia | 7,142 | | 7,142 | 19 |
| Dominican Rep | 272 | 30 | 302 | 17 |
| Guatemala | 174 | 108 | 282 | 10 |
| Honduras | 51 | 16 | 67 | 2 |
| Mexico | 23,938 | 539 | 24,477 | 19 |
| Peru | 11,737 | 286 | 12,023 | 10 |
| Uruguay | 95 | 15 | 110 | 2 |
| **South America Total** | **117,569** | **3,679** | **121,248** | **834** |
| | | | | |
| **Grand Total** | **2,244,214** | **522,852** | **2,767,067** | **2,600** |

**3.6**

| **Banks Trade Finance Products** | **Insurance solution offered globally to support banks** |
|---|---|
| Sales Factoring | Factoring Policy |
| Channel Finance Program | Supply Chain Policy |
| Vendor/Purchase Financing | Top Buyer covers |
| LC discounting/ Buyers Credit | Purchase Finance Programs |
| SBLC backed funding | LC/ SBLC Non-honour Covers |

**FACTORING VS BANK FINANCE: -**

| Factoring | Bank Finance |
|---|---|
| Receivables are Assigned / Purchased | Receivables are Hypothecated |
| Factoring Limit - Off Balance Sheet (Non-Recourse) | Bank Limit reflects on Balance Sheet as Loan |
| Unsecured | Mostly Secured |
| Receivables get converted into Cash | Receivables remain as Debtors |
| Factoring Limit is based on future Sales | Bank Limit is based on Balance Sheet |
| Factoring is based on Client's performance of goods and Debtor's Creditworthiness | Banking Limit is based on Client's Creditworthiness |
| Collection Services | No Collection Services provided |
| No Penalty on Overdues | Penal Interest on Overdue |
| Buyer Concentration approach | Client Concentration approach |

Factoring is an accepted method of receivables financing across the globe and is regulated by a stringent set of rules and procedures. Initially, in India, factoring was not a typical or mainstream financial service in the absence of legislation. However, with the enactment of Factoring Regulation Act, the necessary legal framework is now in place for factoring to gain traction. But unfortunately, reservations on part of corporates and PSU buyers to accept assignment of receivables made in favour of factors, issues with the legal system and dominance of banks in factoring business have been hampering the growth.

Sources: -

- RBI Website https://m.rbi.org.in/Scripts/FAQView.aspx?Id=88
- IFC Factoring Figures 2018 https://fci.nl/downloads/Annual%20Review%202019.pdf
- (https://www.rbi.org.in/Scripts/PublicationReportDetails.aspx?UrlPage=&ID=924) Report on the expert committee on Micro Small and Medium Enterprises dated June 2019 Chaired by Shri U.K.Sinha

# CHAPTER 4

## Micro, Small & Medium Enterprises

### 4.1

### MSMEs Snapshot In India:

- **Number of MSMEs in India:** The number is estimated to be 42.50 million, registered & unregistered together. A staggering 95% of the total industrial units in the country.
- **MSMEs& Employment opportunity:** Employs about 106 million, 40% of India's workforce. Next only to the agricultural sector.
- **Products:** Produces more than 6000 products.
- **GDP Contribution:** Currently around 6.11% of the Manufacturing Sector GDP and 24.63% of Services Sector GDP
- **MSMEs Output:** 45% of the total Indian Manufacturing Output.
- **MSMEs Exports:** 40% of the total Exports.
- **Bank Lending:** Accounts for approx. 16% of Bank Lending.
- **MSMEs Growth Rate:** Consistent Average Growth Rate of over 10%.

India is one of the fastest growing economies of the world. In the last half-decade, the economic growth has steadily accelerated and most importantly, remained very stable. This growth has been driven by robust socio-economic policies of the government, an influx in the domestic and foreign capital and rise in disposable income and consumption among many other positive attributes.

The Indian MSME sector is the backbone of the national economic structure and has unremittingly acted as the bulwark for the Indian economy, providing it resilience to ward off global economic shocks and adversities. With around 63.4 million units throughout the geographical expanse of the country, MSMEs contribute around 6.11% of the manufacturing GDP and 24.63% of the GDP from service activities as well as 33.4% of India's manufacturing output. They have been able to provide employment to around 120 million persons and contribute around 45% of the overall exports from India. The sector has consistently maintained a growth rate of over 10%. About 20% of the MSMEs are based out of rural areas, which indicates the deployment of significant rural workforce in the MSME sector and is an exhibit to the importance of these enterprises in promoting sustainable and inclusive development as well as generating large scale employment, especially in the rural areas.

**4.2**

The term MSME is widely used to describe small business often lacking formalized institutional processes. Governments & financial Institutions around the world have varied definitions for the sector – sometimes vary even between the public & private sectors within the same country. Criteria often use to classify as an MSME include number of employees, annual sales, total assets, type of assets, urban or rural location of enterprise & their financial need.

In India, the government's criteria for MSMEs is different from the definition the World Bank follows – based solely on whether an enterprise is operating in a manufacturing or service industry. MSMEs are classified based on their investment in plant & machinery for a manufacturing enterprise or investment in equipment for a service enterprise. This definition was established in the Micro, Small & Medium enterprise development Act (MSMED Act) of 2006.

While there has been concern raised that this definition is outdated & does not include enterprises that may be larger than the specified criteria but still face similar challenges & conditions as MSMEs, the definition provided below is the most widely accepted classification of MSMEs based on which policies for the sector are created & implemented.

## MSMED Act definitions of MSMEs

| Classification | Manufacturing Enterprise – Investment Limit in Plant & Machinery | Service Enterprise – Investment Limit in Equipment |
|---|---|---|
| Micro | INR 2.5 million (USD 40,000) | INR 1 million (USD 15,000) |
| Small | INR 50 million (USD 0.8 million) | INR 20 million (USD 0.3 million) |
| Medium | INR 100 million (USD 1.5 million) | INR 50 million (USD 0.8 million) |

Just about 15% of the business in the sector are registered enterprises while the huge balance is all unregistered. In order to encourage registration, the ministry of Micro, Small & Medium enterprises has simplified the registration process, replacing the earlier two-stage registration process with a one-step filling of memorandum.

Even though the sector is classified into Micro, Small & Medium as defined by the MSMED Act, almost 95% of the Sector comprises Micro Enterprises, 4.9% Small Enterprises & 0.1% Medium enterprises.

Simultaneously, the ownership Structure accounting to 94% for all MSMEs primarily is proprietorship because this structure requires lower legal overheads.

| Ownership Structure | Share of MSME Sector |
|---|---|
| Proprietorship | 93.83% |
| Partnership | 1.53% |
| Private Company | 0.23% |
| Public Company | 0.04% |
| Cooperative | 0.13% |
| Other | 4.24% |

**4.3**

Even though the small and medium-sized enterprises (SMEs) sector contributes to a large chunk of India's GDP, traditional inefficient methods of operating business and the low rate of technology adoption has hindered smaller business to achieve their potential.

However, despite its contribution to the socio-economic growth of India, SMEs face a number of challenges:

- Lack of capital due to inadequate access to finance and credit
- Inability to attract talented and tech-savvy manpower
- Poor infrastructure and utilities resulting in low production capacity
- Lack of innovation
- Technology and digital knowledge gap
- Lack of marketing know-how

Due to these challenges, the Indian SMEs are unable to scale to their full potential, rise up to the standards of their international peers and become self-sustainable. On the positive side, these challenges should be perceived as untapped opportunities for the SME sector. These challenges offer a broad scope to strengthen the foundation of SMEs in India.

Micro, Small and Medium Enterprise (MSME) sector has emerged as a very important sector of the Indian economy, contributing significantly to employment generation, innovation, exports, and inclusive growth of the economy. Micro, Small and Medium Enterprises (MSMEs) are amongst the strongest drivers of economic development, innovation and employment.

India is currently one of the fastest growing economies of the world. MSME sector is likely to continue to play a significant role in the growth of the Indian economy. In the last ten years, MSME sector has shown impressive growth in terms of parameters like number of units, production, employment, and exports. Given the right set of support systems and enabling framework, this sector can contribute much more, enabling it to actualize its immense potential.

**4.4**

**Seven components of the MSME ecosystem: -**

| Pillar | Description |
|---|---|
| **Human Capital Development** | Enabling entrepreneurship and skill development to build human capital for the sector |
| **Knowledge Dissemination** | Enabling one-stop information sources to resolve information asymmetry |
| **Access to Finance including Insurance** | Enabling timely access to credit and insurance products |
| **Access to Technology** | Enabling development of emerging technology ecosystem |
| **Common Facility Infrastructure** | Enabling incubation, plug and play facilities in major clusters |
| **Facilitating Access to Markets** | Enabling improved access to markets including digital marketing enablement |
| **Policy Governance and Ease of Doing Business** | Enabling responsive policy formulation |

**4.5**

**MSME Credit Demand and Gap Estimates:**

In India, the total addressable demand for external credit is estimated to be37 trillion while the overall supply of finance from formal sources is estimated to be ₹14.5 trillion Therefore, the overall credit gap in the MSME sector is estimated to be ₹20 – 25 trillion.

At an aggregate level, the banking sector has credit outstanding to MSMEs of approximately ₹17.4 trillion as on March 31, 2019. SCBs account for 90% of the share of this, although NBFCs have grown at a healthy rate in recent years.

- The micro segment (<1cr is the fastest growing segment and accounts for ₹4.3 lakh crore out of the total of ₹14.3 lakh crore outstanding MSME credit). This segment grew at 22% y-o-y in 2018. This segment also exhibits the lowest NPAs, although in absolute terms still high at 8.5%.

- As per RBI data, the share of NBFCs in outstanding credit to MSME was 9.3% in March 2019. This trend is expected to accelerate with the emergence of FinTech (typically registered as NBFCs) focused on this segment.

- Share of NBFCs in outstanding credit to Medium enterprises has also become significant. As of March 2018, credit from NBFCs was 17% of the total credit extended by SCBs and NBFCs to Medium enterprises, as per RBI data.

**Barriers to MSME Lending and Late Payment Issues**

Despite an ongoing policy focus, growth of MSME credit has been weak. MSMEs lack access to formal credit as banks face challenges in credit risk assessment of

MSMEs on account of lack of financial information, historical cash flow, etc. Years of mandated lending have not produced enough progress and new approaches are needed. At an overall level, India's banking system is still small relative to the needs of the real sector. Against this backdrop, MSMEs find it challenging to access adequate credit. First, the risk in lending to MSME sector are high as the risks in turn can be traced to inability to pay and unwillingness to pay. The former can in turn be traced to business risk factors such as delayed buyer payments embedded in supply chains or supplying to Government entities and also other business risks, including changes in consumer demand or extraneous events that create a slow-down in the market. MSMEs often have little to no equity buffers.

MSEs face problems of delayed payments and hesitate to enforce the legal provisions available to them under the MSMED Act due to their low bargaining power. MSEs face problems of delayed payments because of low bargaining power not only from corporates but also from PSUs and Government Agencies, both Central and State which adversely affects their working capital cycle/requirements and ultimately affects their operational efficiency. As timely payments to MSEs is of least priority to the buyers, the solution must be necessarily designed around the buyers.

**4.6**

**<u>Trade Receivables Discounting System (TReDS)</u>**

As per RBI, The scheme for setting up and operating the institutional mechanism for facilitating the financing of trade receivables of MSMEs from corporate and other buyers, including Government Departments and Public Sector Undertakings (PSUs), through multiple financiers will be known as Trade Receivables Discounting System (TReDS).

The TReDS will facilitate the discounting of both invoices as well as bills of exchange. Further, as the underlying entities are the same (MSMEs and corporate and other buyers, including Government Departments and PSUs), the TReDS could deal with both receivables factoring as well as reverse factoring so that higher transaction volumes come into the system and facilitate better pricing. The transactions processed under TReDS will be "without recourse" to the MSMEs.

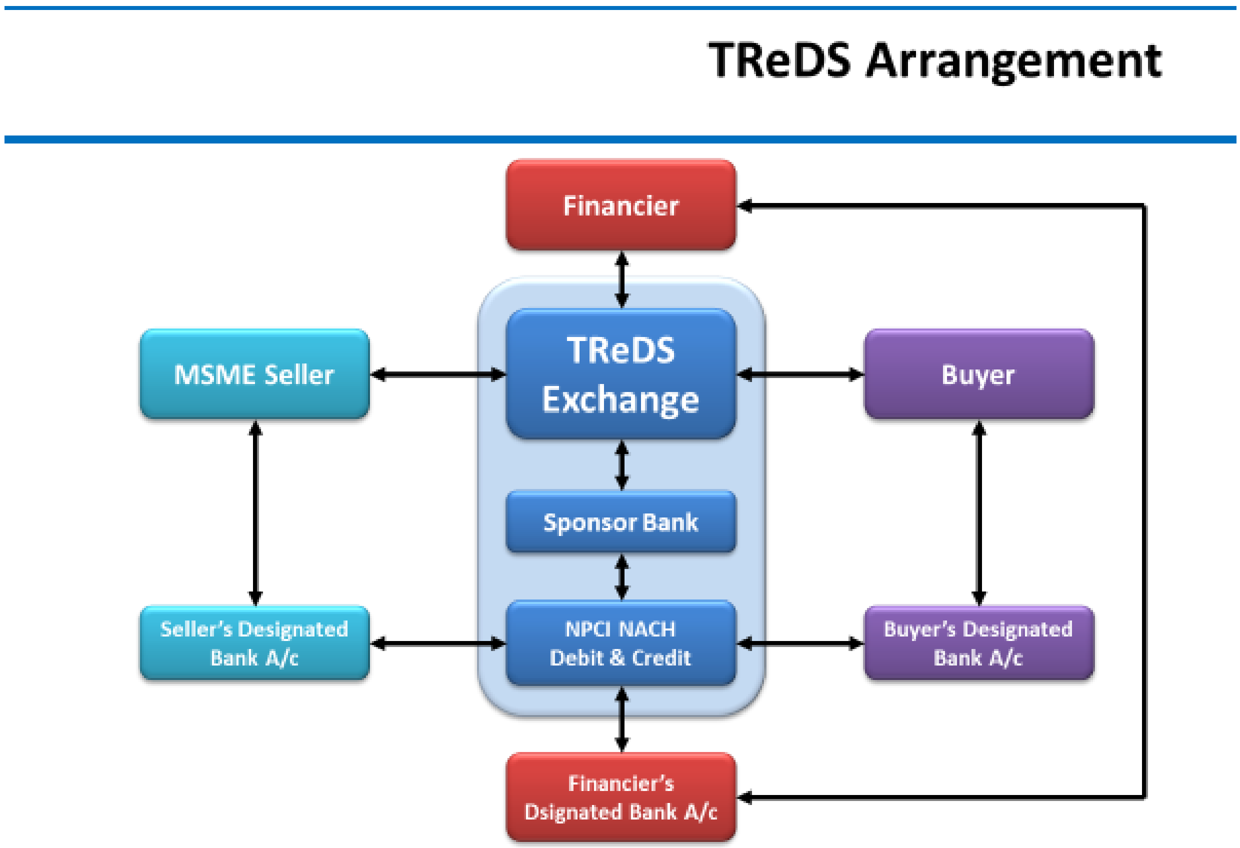
Trade Receivables Discounting System (TReDS) RBI introduced TReDS in 2014 in order to solve the problem of delayed payments to MSMEs, TReDS is an electronic platform where receivables of MSMEs drawn against buyers (large corporates, PSUs, Government Departments, etc.) are financed through multiple financiers at competitive rates through an auction mechanism. Presently, three entities viz., Receivables Exchange of India Ltd. (RXIL), A. TREDS, and Mynd Solutions licensed by RBI are operating the platform for more than two years. The summary of traction gained on the TReDS platform as on March 31, 2019 is given in Table XIX below:

**Table XIX: Traction gained on TReDS platforms**

| Participants registered | | | | Invoices financed | |
|---|---|---|---|---|---|
| MSME Sellers | Buyers | Banks | NBFC Factors | No. of Invoices | Amount (₹ in Billion) |
| 3708 | 604 | 71 | 5 | 251988 | 66.69 |

*Source: Data submitted by TReDS entities to RBI*

**Leveraging TReDS Platform Ecosystem for Credit Insurance:**




CREDIT INSURANCE to be provided to Financier against default of Buyer on TReDS Exchange. Policy per transaction to be issued by Exchange.

a) Corporate and other buyers, including Government Departments and Public Sector Undertakings, send purchase order to MSME seller (outside the purview of the TReDS).

b) MSME seller delivers the goods along with an invoice. There may or may not be an accepted bill of exchange depending on the trade practice between the buyer and the seller (outside the purview of the TReDS).

c) Thereafter, on the basis of either an invoice or a bill of exchange, the MSME seller creates a 'factoring unit' (which would be a standard nomenclature used in the TReDS for an invoice or a bill on the system) on TReDS. Subsequently, the buyer also logs on to TReDS and flags this factoring unit as 'accepted'. In case of reverse factoring, this process of creation of factoring unit could be initiated by the buyer.

d) Supporting documents evidencing movement of goods etc. may also be hosted by the MSME seller on the TReDS in accordance with the standard list or check-list of acceptable documents indicated in the TReDS.

e) The TReDS will standardize the time window available for buyers to 'accept' the factoring units, which may vary based on the underlying document – an invoice or bill of exchange.

f) The TReDS may have either a single or two separate modules for transactions with invoices and transactions with Bills of Exchange, if so required. In either case, all transactions routed through TReDS will, in effect, deal with factoring units irrespective of whether they represent an invoice or a bill of exchange.

g) Factoring units may be created in each module as required. Each such unit will have the same sanctity and enforceability as allowed for physical instruments under the "Factoring Regulation Act, 2011" or under the "Negotiable Instruments Act, 1881"

h) The standard format / features of the 'factoring unit' will be decided by the TReDS – it could be the entire bill/invoice amount or an amount after adjustment of tax / interest etc. as per existing market practice and as adopted as part of the TReDS procedure. However, each factoring unit will represent a confirmed obligation of the corporate and other buyers, including Government Departments and PSUs, and will carry the following relevant details – details of the seller and the buyer, issue date (could be the date of acceptance), due date, tenor (due date – issue date), balance tenor (due date – current date), amount due, unique identification number generated by the TReDS, account details of seller for financier's reference (for credit at the time of financing), account details of buyer for financier's reference (for debit on the due date), the underlying commodity (or service if enabled).

i) The TReDS should be able to facilitate filtering of factoring units (by financiers or respective sellers / buyers) on any of the above parameters. In view of the expected high volumes to be processed under TReDS, this would provide the necessary flexibility of operations to the stakeholders.

j) The buyer’s bank and account details form an integral feature of the factoring unit. The creation of a factoring unit on TReDS shall result in automatic generation of a notice / advice to the buyer’s bank informing them of such units.

k) These factoring units will be available for financing by any of the financiers registered on the system. The all-in-cost quoted by the financier will be available on the TReDS. This price can only be viewed by the MSME seller and not available for other financiers.

l) There will be a window period provided for financiers to quote their bids against factoring units. Financiers will be free to determine the time-validity of their bid price. Once accepted by the MSME seller, there will be no option for financiers to revise their bids quoted online.

m) The MSME seller is free to accept any of the bids and the financier will receive the necessary intimation. Financiers will finance the balance tenor on the factoring unit.

n) Once a bid is accepted, the factoring unit will get tagged as “financed” and the funds will be credited to the seller’s account by the financier on T+2 basis (T being the date of bid acceptance). The actual settlement of such funds will be as outlined under the Settlement section.

o) Once an accepted factoring unit has been financed by a financier, notice would be sent to buyer’s bank as well as seller’s bank. While the buyer’s bank would use this information to ensure availability of funds and also handle the direct debit to the buyer’s account on the due date in favour of the financier (based on the settlement obligations generated by the TReDS), the seller’s bank will use this input to adjust against the working capital of the MSME seller, as necessary (the TReDS procedures may, if necessary, also indicate that the proceeds of the accepted and financed factoring units will be remitted to the existing working capital / cash credit account of the MSME seller). If agreed by members, the TReDS may also provide the option to members, whereby the financiers would take direct exposure against the buyers rather than through their bankers.

p) On the due date, the financier will have to receive funds from the buyer. The TReDS will send due notifications to the buyers and their banks advising them of payments due. The actual settlement of such funds will be as outlined under the Settlement section.

q) Non-payment by the buyer on the due date to their banker should tantamount to a default by the buyer (and be reported as such as per regulatory procedures prescribed from time to time) and enable the banker to proceed against the buyer. Any action initiated in this regard, will be strictly non-recourse with respect to the MSME sellers and outside the purview of the TReDS.

r) These instruments may be rated by the TReDS on the basis of external rating of the buyer, its credit history, the nature of the underlying instrument (invoice or bill of exchange), previous instances of delays or defaults by the buyer with respect to transactions on TReDS, etc.

s) The rated instruments may then be further transacted / discounted amongst the financiers in the secondary segment.

t) Similar to the primary segment, any successful trade in the secondary segment will also automatically result in a direct debit authority being enabled by the buyer's bank in favour of the financier (based on the settlement obligations generated by the TReDS). In parallel, it will also generate a 'notice of assignment' intimating the buyer to make the payment to the new financier.

u) In the event that a factoring unit remains unfinanced, the buyer will pay the MSME seller outside of the TReDS.

In order to meet the requirements of various stakeholders, the TReDS should ensure to provide various types of MIS reports including intimation of total receivables position, financed and unfinanced (to sellers); intimation of outstanding position, financed and unfinanced with details of beneficiaries and beneficiary accounts to be credited (for buyers); total financed position for financiers; etc. Similarly, data on unfinanced factoring units in the market should also be made available by the TReDS. The system should also generate due date reminders to relevant parties, notifications to be issued to bankers when a factoring unit is financed, notifications to be issued to buyers once a factoring unit related to their transaction is traded in the secondary segment, etc.

**Sources: -**


- Financing India's MSMEs - (https://www.ifc.org/wps/wcm/connect/dcf9d09d-68ad-4e54-b9b7-614c143735fb/Financing+India%E2%80%99s+MSMEs+-+Estimation+of+Debt+Requirement+of+MSMEs+in+India.pdf?MOD=AJPERES&CVID=my3Cmzl)
- https://www.nasscom.in/about-us/what-we-do/industry-development/sme-landscape
- https://www.cii.in/Sectors.aspx?enc=prvePUj2bdMtgTmvPwvisYH+5EnGjyGXO9hLECvTuNuXK6QP3tp4gPGuPr/xpT2f
- *msme.gov.in*/*KPMG*/*CRISIL*/*CII*
- https://m.rbi.org.in/Scripts/bs_viewcontent.aspx?Id=3504

# CHAPTER – 5

## Trade Credit Guidelines Recommendations

| | EXISTING GUIDELINES | PROPOSED CHANGES | COMMENTS |
|---|---|---|---|
| I | **Definitions** | | |
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| A | **"Buyer"** means any person/business entity, who is liable to pay policy-holder, for a trade credit transaction on open and agreed terms. | **"Buyer"** means any business entity, who is liable to pay policy-holder, for a trade credit transaction on open and agreed terms. | Individual Person cannot be a buyer. |
| B | **"Credit Limit"** is the credit limit set by the insurer for every buyer with whom the policy holder trade. 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. | **"Credit Limit"** is the credit limit set by the insurer for every buyer with whom the policy holder trade. The level of the limit is set at the maximum amount of exposure acceptable to insurer in normal circumstances in respect of the amount 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. | Modified to have better clarity |
| C | **"Factoring"** means the business of acquisition of receivables of assign or by accepting assignment of such receivables or financing, whether by way of making loans or advances or otherwise against the security interest over any receivables | Continue with the existing definition. | |

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| **D** | **"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. | **"Financial Guarantee" as defined by ICISA** 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 & amendments thereof. | |
| **E** | **"Granted credit limit"** is the maximum insured credit line for a specific buyer and the policy holders can trade on an insured basis within the approved credit limit throughout the policy period without further reference to the insurer. | Continue with the existing definition. | |
| **F** | **"Insolvency (Bankruptcy)"** A judicial or administrative procedure where by 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 reorganization or liquidation of the buyer or of the rescheduling, settlement or | Continue with the existing definition. | |

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| | suspension of payment of its debts. | | |
| G | **"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. | **"Maximum liability amount"** is maximum loss that can be paid under one single policy. If the total loss of a policy occurring during the policy year exceeds the amount of the agreed maximum liability, the aggregate claim amount under this policy is limited to this amount. | Modified to have better clarity |
| H | **"Reverse Factoring arrangement"** means any arrangement in whatever name or form, between a borrower and a financer, wherein a borrower receives or is supposed to receive finance, either directly or indirectly, for borrower's purchase of trade receivables, goods or services. | Continue with the existing definition. | |
| I | **"Seller"** means a person or business entity who sells the underlying goods or services, for a trade credit transaction, on open and agreed terms. | Continue with the existing definition. | |
| J | **"Trade Credit Insurance business"** means the business of effecting contracts of insurance in respect of trade credit transactions. | Continue with the existing definition. | |

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| **K** | **"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 those countries agreed upon at the proposal stage. | Continue with the existing definition. | |
| **L** | **"Trade Credit transaction"** means a transaction between two persons and or entities, for supply of goods or services on open and agreed terms. | **"Trade Credit transaction"** means a transaction between two legal entities, for supply of goods or services on open and agreed terms. | Trade Credit Insurance cannot insure an individual hence the person word has to be removed. |
| **M** | **"Transaction on open terms"** means a transaction which is not cash based transaction. | **"Transaction on open terms"** means a transaction which is not backed by advance payment. | Modified to have better clarity |
| **N** | **"Trade receivable"** means a receivable in the hands of seller arising out of a trade credit transaction. | Continue with the existing definition. | |
| **O** | **"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 | Continue with the existing definition. | |

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| | underlying trade transaction, which is either the delivery of goods or of services. The correct fulfillment of this trade transaction and satisfaction of the contract terms is essential for credit cover to exist | | |
| **P** | **"Whole turnover trade credit insurance policy"** means a trade credit insurance policy that covers all trade credit receivables of all buyers, pertaining to a seller. | Continue with the existing definition. | |
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| | **ADDITIONAL DEFINITIONS Proposed** | **ADDITIONAL DEFINITIONS Proposed** | |
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| **Q** | Policy Holder | "**Policy-holder**" may be a:<br>I) Seller / Supplier of goods or services.<br>II) Factoring company as defined by The Factoring Regulation Act 2011 & amendments thereof.<br>III) Bank / Financial Institution, engaged in Trade Finance, registered & regulated by Regulatory Bodies | Policy Holder was not defined in the earlier circular. |
| **R** | TReDS or Invoice Discounting e-Platforms | "TReDS" or Invoice Discounting e-Platforms means any Institutional platform facilitating the financing or discounting or similar arrangements of trade receivables through sole or multiple financiers through electronic platform. | |

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| **S** | "Pre-Shipment Cover" | "Pre-Shipment Cover" means the commercial risk of Insolvency of a buyer before delivery or shipment of goods or performance of service and /or the political risk of interruption of the manufacturing of the goods or performance of a service | |
| **T** | Micro & Small Enterprises | Micro & Small Enterprises shall be as defined by the MSMED Act, 2006 and amendments thereof. | |
| **U** | Government Buyer | "Government Buyer" means any entity that is authorized to enter into commitments in the name or on behalf of the government of its country, including the government itself or government agencies whose commitments are guaranteed by the government. | |
| **V** | Project Cover | “Project Cover” means insurance of receivables against non-payment by the principal or buyer provided to a contractor engaged in but not limited to long term infrastructure, civil and industrial projects and services. The project period should be more than 6 months. | |
| **W** | Net Retention | "Net Retention" means net exposure of the Insurance Company after considering the existing reinsurance arrangements | |
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| **II** | **Applicability of 'Guidelines on Product Filing Procedures for General Insurance Products" to trade credit insurance** | | |
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| **1** | No insurer shall issue a financial guarantee. | Continue with the existing provision. | |
| **2** | All the existing credit insurance policies shall remain valid as per original contract terms and conditions, till the expiry of the current contract period. The insurers are directed to review the creditworthiness of the buyers and credit assessment and management practices of the policy holders under the existing credit insurance policies currently in force and ensure that necessary corrective action is taken. | Continue with the existing provision. | |
| **3** | All Trade Credit Insurance policies will be subject to "file & use procedures'' as stipulated under the "Guidelines on Product Filing Procedures for General Insurance Products" issued by the Authority. No trade credit insurance policy shall be sold unless the product has prior approval of the Authority. | Continue with the existing provision. | |
| **4** | The insurers intending to underwrite trade credit insurance business shall file their products/revised products, under "Product Filing Procedures" and these | Continue with the existing provision. | |

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| | guidelines. | | |
| **5** | 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. | Continue with the existing provision. | |
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| **III** | **<u>Basic Requirements of a Trade Credit Insurance Policy</u>** | | |
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| | An insurer shall offer trade credit insurance policy only if all the following minimum requirements are met: | | |
| **1** | Policyholder's loss is non receipt of trade receivable arising out of a trade of goods or services. | Policyholder's loss is non receipt of trade receivable arising out of an underlying trade transaction. | This definition has been modified to include policies issued to Banks/FIs/Factors as they are not sellers. |
| **2** | Policy-holder is a supplier of goods or services, in consideration for a fair market value. | to be deleted | Policy Holder is defined in I (Q) |
| **3** | No trade credit insurance policy shall cover factoring, reverse factoring, bill discounting or any other similar arrangement. | No Trade Credit insurance policy shall cover reverse factoring or any other similar arrangement except for cross border transaction | The revised guidelines propose to allow policies to be issued to Banks / FIs and Factors. However, since reverse factoring transactions are risky and will involve anti selection of buyers, we propose to allow it only for cross border transactions. |

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| **4** | Policy-holder has a customer (i.e. Buyer) who is liable to pay a trade receivable to the Policy-holder in return for the goods and services received by him from the seller, in accordance with a policy document filed with the insurer. | There should be a Policy Holder and Buyer as defined in Section I (Q) and I (A) respectively. | |
| **5** | Policy-holder undertakes to pay premium for the entire Policy Period. | Continue with the existing provision. | |
| **6** | Any other requirement that may be specified by the Authority from time to time. | Continue with the existing provision. | |
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| **IV** | **<u>Conditions on Trade Credit Insurance</u>** | | |
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| **A** | **Insurer** | | |
| **1** | A trade credit insurance policy shall not be issued to banks/financiers/lenders. | A trade credit insurance policy shall be issued to banks/financiers/lenders for Trade Related Transactions except for covering loan default of seller. | A credit insurance policy only covers default by a buyer. It does not cover default by the seller/exporter. |
| **2** | Assignment of proceeds of a claim under a trade credit policy may be made to a bank / NBFC registered with RBI, in the manner prescribed under Section 38 of the Insurance Act 1938. | May be deleted | Assignment is already a part of revised Insurance laws (Amendment) Act 2015 |
| **3** | A trade credit insurance policy shall not offer cover to any receivable arising from transactions made other than trade credit transaction. | Continue with the existing provision. | |

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| **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. | Continue with the existing provision. | |
| **5** | A trade credit insurance policy can be sold to seller on whole credit turnover basis only, covering all buyers. However, if the seller prefers to take credit insurance cover for a segment /product/or country, the same shall be allowed provided the cover is taken for the whole credit turnover of all buyers of that particular segment / product or country. | A trade credit insurance policy can be sold on<br><br>1). whole turnover basis to cover all buyers of that particular segment / product / country.<br><br>2). Individual buyer covers can be issued only for:<br>a). Micro & Small Enterprises. (as defined in I (T))<br>b). Project covers (as defined in I (V))<br>c). Bank / FIs / Factoring / Similar Arrangements<br><br>3). Single Invoice Covers through bill discounting / Factoring / Similar Arrangements shall be allowed only on Invoice Discounting e-Platforms. | |
| **6** | The cover under trade credit insurance policy is available only to pre-agreed buyers and upto the limits agreed. Any change in the limits can be effected only after prior approval of the insurer. | Continue with the existing provision. | |

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| **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. | Continue with the existing provision. | |
| **8** | An insurer shall necessarily assess the credit risk of any buyer who contributes more than 2% of the total turnover of the policy holder. | to be deleted | It is proposed that every Insurer shall have Board Approved Risk Management Guidelines which will be filed with the Authority. |
| **9** | Every trade credit insurance policy shall carry a subrogation condition and no waiver under any circumstances shall be allowed. | Continue with the existing provision. | |
| **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 policy holder 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 policy holder to the buyer after the date of insurer's decision to reduce or cancel the limits. | Continue with the existing provision. | |

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| **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 policy holder 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. | Every insurer shall appoint a credit management agency or have a Credit Management services arrangement with a Reinsurer or have an internal system of assessment with the approval of the Board of Directors for the purposes of assessing creditworthiness of the policy holder 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. | Many Reinsurance arrangements provide for technical support for risk underwriting. Some Insurers have developed their own internal system of risk underwriting and are not dependent on external agencies for risk assessment. Hence the guidelines are modified to reflects various arrangements available to Insurers. |
| **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 policy holder. | The insurer availing the services of a credit management agency, shall ensure that there is no conflict of interest of the credit management agency with the policy holder. | Modified in the context of the revision proposed in the earlier para. |
| **13** | A single specific trade credit policy covering only one shipment cannot be sold to a prospect. The insurer can issue credit insurance even if the number of buyers is very small. However, the insurer needs to exercise due diligence and caution if the buyers sought to be covered are very small in number. | to be deleted | The specific shipment/invoice cover has already been addressed in para IV 5 |
| **14** | No trade credit insurance policy is allowed when governmental, para governmental agencies are the buyers. | No trade credit insurance policy shall cover Government Buyers as defined under para I (U). | Clarified the definition of Govt Buyer under Para I (U) |
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| B | Policyholder | | |
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| 1 | A Policy-holder cannot take out more than one trade credit insurance Policy either with the same insurer or any other insurer in respect of the same Buyer risk nor can the insurer issue more than one trade credit insurance policy covering same risks emanating for or from the same entity. | Continue with the existing provision. | |
| 2 | A trade credit policy shall not grant an indemnity of more than 85% of the trade receivables from each buyer. | A trade credit policy shall not grant an indemnity of more than 90% of the trade receivables from each buyer for all policyholders and 95% in case of political risks only for Micro & Small Enterprises (defined in para I (T)) when they are the policy holder. | 90% cover is in line with global standards. 95% indemnity is proposed for political risk only for Micro & Small Enterprises to provide relief in the event of loss which is beyond their control. |
| 3 | A Policy-holder shall be obliged under the Policy to notify adverse information about the Buyer to the insurer. | Continue with the existing provision. | |
| 4 | A Policy-holder shall not be covered for Buyer's non-payment of a trade receivable on account of dispute with the Policy-holder or supplier of the goods or services until the dispute gets resolved. | Continue with the existing provision. | |
| 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. | Continue with the existing provision. | |

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| **V** | **<u>Trade Credit Insurance Underwriting</u>** | **<u>Trade Credit Insurance Underwriting & Risk Management</u>** | |
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| **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, discounting premium rates, loss deductibles, maximum liability, premium pricing in case of higher risk or loss perception, no-claim bonus, etc. | Every Insurer underwriting Trade Credit Insurance Business shall have Borad Approved Underwriting and Risk Management Policy, which shall be filed with the Authority. | Para V and VI have been combined. Every Insurer has Board approved guidelines to write and manage risk. Also in case of non incorporated entities financial information is not easily available. Cover is also required mainly in this segment. Every Insurer has developed its own mechanism to underwrite such buyers. |
| **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. | to be deleted | |
| **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 | to be deleted | |

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| | which the Board of Directors deem fit. | | |
| **4** | The insurer shall take into consideration the following minimum parameters for underwriting of the Policy:<br>a)Risk Pricing;<br>b)Trade Sector/Industry of the Buyer;<br>c)Level of Insurable Turnover;<br>d)Debtors Turnover / Velocity in comparison to the Credit Terms / Terms of Payment offered to the Buyer;<br>e)Quality of Buyer Base and spread of Risk;<br>f)Bad Debts History of the Prospect;<br>g)Internal Credit Management of the Prospect | to be deleted | |
| **5** | The insurer shall file with the Authority the rating model for the insurance cover to be offered in the market | to be deleted | |
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| **VI** | <u>**Risk Management for trade credit insurance**</u> | | |
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| **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. | to be deleted | |
| **2** | The insurer shall construct suitable risk management models, which articulate its | to be deleted | |

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| | 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. | to be deleted | |
| **4** | The insurer shall ensure that the following minimum parameters are taken into account while framing Risk management Guidelines: | to be deleted | |
| **a)** | Financial Parameters relating to the Buyer | | |
| | i) Buyer turnover for current and three previous years, | to be deleted | |
| | ii) Yearly Profitability trends, gross, operating and net margins of the buyer for current and three previous years, | to be deleted | |
| | iii) Yearly operating cashflows for current and three previous years, | to be deleted | |
| | iv) Asset turnover ratio and current ratio for current and three previous years. | to be deleted | |
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| **b)** | Non-Financial Information about the Buyer. | to be deleted | |
| | i) Business activity of the | to be deleted | |

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| | Buyer | | |
| | ii) Business and Political environment and the Industry in which the Buyer operates in | to be deleted | |
| | iii) Promoters of the Buyer, their experience, background and track record for the past and current period | to be deleted | |
| | iv) Market information on promoters of the Buyer in the media | to be deleted | |
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| **c)** | 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 upto the Audit Committee of the Board at half-yearly intervals. | to be deleted | |
| **d)** | The insurer shall also provide systems and checks to ensure that delegated powers are exercised prudently and judiciously by the authorized officials and has no adverse fallout. | to be deleted | |
| **e)** | Where fewer than 10 buyers are to be covered the insurer shall use appropriate policy conditions and underwriting techniques, to place extremely prudent compliance obligations on the insured. | to be deleted | |

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| **VII** | **Claims Handling** | | |
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| **1** | The insurer shall have a comprehensive "Claims Manual" which gives the manner in which the claims shall be processed, documentation, delegation of authority, policy holders servicing, grievance redressal etc. | Continue with the existing provision. | |
| **2** | The insurer shall also have a strong and efficient recovery mechanism in place to follow-up on defaults. | Continue with the existing provision. | |
| **3** | In respect of claims in excess of retention limits, the direct insurer shall Intimate the reinsurer immediately on receiving intimation of the loss. | Continue with the existing provision. | |
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| **VIII** | **Reinsurance Arrangements** | | |
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| **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 | Continue with the existing provision. | |

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| | 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 where in 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 Policy-holder. | The general insurance conditions applying to trade credit insurance will form an integral part of the Reinsurance agreement. The Reinsurer shall, subject to the terms and conditions of the agreement, follow the underwriting fortunes of the Reinsured in respect of the risks which the Reinsured has accepted in good faith under insurance contracts and the cover notes. | Have reworded to add better clarity. |
| **3** | The aggregate net retentions of the insurer for trade credit insurance shall not exceed 5% of his net-worth. | The aggregate net retentions of the insurer for trade credit insurance shall be as per the applicable reinsurance regulations & amendments thereof. | |
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| **IX** | **Experience and Training Requirements for employees dealing with trade credit insurance** | | |
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| | Every insurer wanting to write trade credit insurance shall ensure that decisions of acceptance of trade credit insurance business are made | Continue with the existing provision. | |

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| | by persons with necessary knowledge, training and experience in the areas of underwriting, risks management, claims, reinsurance, etc. Brief details relating to these aspects shall be filed along with the Product Filing documents to IRDAI. | | |
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| **X** | **<u>Reporting requirements to IRDAI</u>** | | |
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| **1** | The Insurer should report following information with IRDAI: | Continue with the existing provision. | |
| | a) Policy-holder wise earned and gross written premium | | |
| | b) Loss ratio for the trade credit insurance product | | |
| | c) Policy-holder wise - Buyer wise claims reserves | | |
| | d) Policy-holder wise - Buyer wise claims paid | | |
| | e) Policy-holder wise - Buyer wise claims recovery | | |
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| **2** | Periodic reporting | Continue with the existing provision. | |
| **a** | The Insurer should report the above mentioned information as follows: | | |

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| | i) Every six months-Within 30 days of every six months ending on 30th | | |
| | September and 31stMarch | | |
| | ii) Every year-within 30days of the end of 12month period on 31"March for each financial year | | |
| | iii) Every loss known to the insurer, which is in excess of 1% of the networth of the insurer, as and when intimation is received by the insurer. | | |
| **b** | The Insurer should provide for additional reports / clarifications demanded by IRDAI within 15 days of the receipt of requisition from IRDAI. | | |
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| **XII** | **Further powers of the Authority** | | |
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| **1** | The Authority shall have the right to call, inspect or investigate any document, record or communication of the insurer and/or Policy-holder, if it is of the opinion that the continued writing of trade credit insurance business is detriment to the interest of the insurer. | Continue with the existing provision. | |
| **2** | The Authority shall declare any trade credit insurance policy granted in violation of | Continue with the existing provision. | |

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| | these guidelines and other IRDAI 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. | Continue with the existing provision. | |
| **4** | In order to remove any difficulties in respect of the application or interpretation of any of the provisions of these guidelines, the Chairperson of the Authority may issue appropriate clarifications from time to time. | Continue with the existing provision. | |

# Chapter 6

## Additional Recommendations

1. To create Buyer Default Database with IIB with an access to all the insurance companies providing credit insurance.

2. Access of CIBIL database or similar platforms by Insurance companies for underwriting purposes. Also, a buyer default under Trade Credit Insurance Policy should also be intimated to the Banks through CIBIL or similar platforms

3. Use of Credit Insurance Products by Banks will meaningfully take off only if RBI recognizes credit insurance as credit risk mitigation, equivalent to cash/ securities etc. Currently, RBI prescribes the following while considering credit protection as eligible credit risk mitigation:

    a. General principles wherein RBI recognized guarantees which are direct, explicit, irrevocable and unconditional to be qualified as credit risk mitigant and does not include insurance/ surety companies

        *(Source: RBI's Master Circular on 'Prudential Guidelines on Capital Adequacy and Market Discipline - New Capital Adequacy Framework (NCAF)' dated July 1, 2015- in attached document: Annexure 1)*

    b. Further, it prescribes eligible guarantors which also has no specific mention of Insurance/ surety companies other than ECGC

        *(Source: Master Circular – Basel III Capital Regulations – July 1, 2015- in attached document in Annexure 2)*

    c. Once credit risk mitigation is there, banks can get capital relief while shifting the risk exposure and accordingly calculate their capital requirements. Given credit insurance is not considered as credit risk mitigation, risk transfer to insurance companies, in case of a credit insurance-backed transaction, is currently not allowed.

Insurance companies are not covered under credit risk mitigation as the eligible guarantor thus banks were reluctant to use this as a credit risk mitigation. Hence, it is imperative that in line with the global standards, as also recognized under Basel III, credit insurance to be considered as eligible credit risk mitigation tool under RBI guidelines. Highlighting the key points from the circular released by RBI on NCAF & Basel III regulations in 2015.

4. Guarantee by banks is like Surety Business by Insurance companies across the world which should also be explored for the benefits of our economy through separate guidelines with discussions involving other Regulatory Bodies as well.

# SOURCES


- IRDAI
- ICISA
- Berne Union
- India Factoring
- Trade Credit Insurance by Peter M Jones - http://siteresources.worldbank.org/FINANCIALSECTOR/Resources/Primer15_TradeCreditInsurance_Final.pdf
- RBI Website https://m.rbi.org.in/Scripts/FAQView.aspx?Id=88
- IFC Factoring Figures 2018 - https://fci.nl/downloads/Annual%20Review%202019.pdf
- (https://www.rbi.org.in/Scripts/PublicationReportDetails.aspx?UrlPage=&ID=924) Report on the expert committee on Micro Small and Medium Enterprises dated June 2019 Chaired by Shri U.K.Sinha
- Financing India's MSMEs - (https://www.ifc.org/wps/wcm/connect/dcf9d09d-68ad-4e54-b9b7-614c143735fb/Financing+India%E2%80%99s+MSMEs+-+Estimation+of+Debt+Requirement+of+MSMEs+in+India.pdf?MOD=AJPERES&CVID=my3Cmzl)
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# ABBREVATIONS

- AML = Anti-Money Laundering
- BIS = Bank for International Settlements
- CBIRC = China Banking & Insurance Regulatory Commission
- CGTSI = Credit Guarantee Fund Trust for Small Industries
- CIBIL = Credit Information Bureau (India) Limited
- CRGFTLIH = Credit Risk Guarantee Fund Trust for Low Income Housing
- ECAs = Export Credit Agencies
- EDPMS = Export Data Processing and Monitoring System
- E-way bill = Electronic Waybill
- FCI = Factors Chain International
- FEMA = Foreign Exchange Management Act
- FIs = Financial Institutions
- GDP = Gross Domestic Premium
- GIC = General Insurance Corporation of India
- IBC = Insolvency and Bankruptcy Code
- ICISA = International Credit Insurance & Surety Association
- IMF = International Monetary Fund
- IRDAI = Insurance Regulatory & Development Authority of India
- KYC = Know your Customer
- LoB = Line of Business
- LC = Letter of Credit
- MIS = Management Information System
- MLT = Medium / Long – Term
- MSMEs = Micro, Small & Medium Enterprises
- MSMED Act = Micro, Small & Medium enterprise development Act
- NBFC = Non-Banking Financial Institution
- NCAF = New Capital Adequacy Framework
- NCGTC = National Credit Guarantee Trustee Company
- NOF = Net Owned Fund
- NPAs = Non Performing Assets
- PSEs = Public sector enterprises
- PRI = Political Risk Insurance
- PRIS = Political Risk Insurance Scheme
- PSU = Public Sector Undertaking
- RBI = Reserve Bank of India
- RXIL = Receivables Exchange of India Ltd

- SBLC = Standby Letter of Credit
- SCBs = Scheduled Commercial Banks
- SIDBI = Small Industries Development Bank of India
- SMEs = Small & Medium Enterprises
- ST TC = Short Term Trade Credit
- TCI = Trade Credit Insurance
- TCIS = Trade Credit Insurance Scheme
- TReDS = Trade Receivables Discounting Exchange

# Annexure 1

भारतीय बीमा विनियामक और विकास प्राधिकरण
INSURANCE REGULATORY AND
DEVELOPMENT AUTHORITY OF INDIA

IRDAI/NL/ORD/MISC/133/08/2019 29th August, 2019

**ORDER**

**Sub: Working Group on Revisiting Guidelines on Trade Credit Insurance**

The Authority had revised the Guidelines on Trade Credit Insurance on 10th March, 2016 vide Circular Ref: IRDAI/NL/CIR/CRE/044/03/2016, considering the changes in economy and the enhanced need for trade credit insurance. Thereafter, representations have been received from various stakeholders to revisit the scope of the trade credit cover. Keeping in view these requests as well the changing requirements of market, the Authority has decided to constitute a Working Group on revisiting Guidelines on Trade Credit Insurance.

2. The Working Group will consist of the following members:

1) Shri. Atul Sahai, CMD, The New India Assurance Co. Ltd, Chairman
2) Shri. Subrata Mondal, EVP & Head–Technical Risk Management & Product Development, Iffco Tokio General Insurance Co Ltd, Member
3) Shri. Mukund Daga, Vice President, Trade Credit, Tata AIG General Insurance Co Ltd, Member
4) Shri. Parag Gupta, CUO, Score SE, Indian Branch, Member
5) Shri.Rajay Sinha, General Manager, IB Domestic, State Bank of India, representing Indian Banks' Association, Member
6) Shri. Umang Rathod, Director, Origin Insurance Brokers India Pvt Ltd, representing Insurance Brokers Association of India, Member
7) Shri. S.P. Chakraborty, General Manager, Actuarial Department, IRDAI, Member
8) Smt. Latha. C, Deputy General Manager, Reinsurance Department, IRDAI, Member
9) Shri. Jyothi Prasad Adike, Manager, Non-Life Department, IRDAI, Member Convener

3. The Terms of Reference of the Working Group are as under:

i. To examine the current guidelines on Trade Credit Insurance and products available for catering to the needs of credit insurance market in India.

ii. To study the need and scope for changes in the current guidelines keeping with the times and requirements of various segments of market.

iii. To suggest suitable amendments to guidelines that adds value to the policyholders and stakeholders such as Banks/Factoring Companies/Lenders.

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iv. To make recommendations with regard to relevant regulatory framework, including guidelines in respect of underwriting, risk management, claims handling, pricing, reserving, accounting etc.

v. To consider the availability of reinsurance support in domestic and international markets.

vi. To examine any other aspect relevant to 'Trade Credit Insurance'.

4. The Working Group shall submit its report in twelve weeks' time from the date of this order.

29/8/19

(Yegnapriya Bharath)
Chief General Manager(NL)

## Annexure 2

**Extracts from RBI master circular on Prudential Guidelines on Capital Adequacy and Market Discipline New Capital Adequacy Framework (NCAF) - July 1, 2015**

(https://rbidocs.rbi.org.in/rdocs/notification/PDFs/85BL4697A788DAB5485B826CFA24D35EA1BE.PDF)

7. Credit Risk Mitigation

7.1 General Principles

7.1.1 Banks use several techniques to mitigate the credit risks to which they are exposed. For example, exposures may be collateralized in whole or in part by cash or securities, deposits from the same counterparty, **guarantee of a third party,** etc. The revised approach to credit risk mitigation allows a wider range of credit risk mitigants to be recognized for regulatory capital purposes than is permitted under the 1988 Framework provided these techniques meet the requirements for legal certainty as described in paragraph 7.2 below. Credit risk mitigation approach as detailed in this section is applicable to the banking book exposures. This will also be applicable for calculation of the counterparty risk charges for OTC derivatives and repo-style transactions booked in the trading book.

**7.5 Credit risk mitigation techniques - guarantees**

7.5.1 Where guarantees are direct, explicit, irrevocable and unconditional; banks may take account of such credit protection in calculating capital requirements.

7.5.2 A range of guarantors are recognized. As under the 1988 Accord, a substitution approach will be applied. Thus, **only guarantees issued by entities with a lower risk weight than the counterparty will lead to reduced capital charges** since the protected portion of the counterparty exposure is assigned the risk weight of the guarantor, whereas the uncovered portion retains the risk weight of the underlying counterparty.

7.5.3 Detailed operational requirements for guarantees eligible for being treated as a credit risk mitigant are as under:

7.5.4 Operational requirements for guarantees

(i) A guarantee (counter-guarantee) **must represent a direct claim on the protection provider** and must be explicitly referenced to specific exposures or a pool of exposures, so that the extent of the cover is clearly defined and incontrovertible. The **guarantee must be irrevocable**; there must be no **clause in the contract that would allow the protection provider unilaterally to cancel the cover or that would increase the effective cost of cover** as a result of deteriorating credit quality in the guaranteed exposure. The **guarantee must also be unconditional**; there should be no clause in the guarantee outside the direct control of the bank that could prevent the protection provider from being obliged to pay out in a timely manner in the event that the original counterparty fails to make the payment(s) due.

(ii) All exposures will be risk weighted after considering risk mitigation available in the form of guarantees. When a guaranteed exposure is classified as non-performing, the guarantee will cease to be a credit risk mitigant and no adjustment would be permissible on account of credit risk mitigation in the form of guarantees. The entire outstanding, net of specific provision and net of realizable value of eligible collaterals / credit risk mitigants, will attract the appropriate risk weight.

7.5.5 Additional operational requirements for guarantees

In addition to the legal certainty requirements in paragraphs 7.2 above, for a guarantee to be recognized, the following conditions must be satisfied:

i) On the qualifying default/non-payment of the counterparty, the bank is able in a timely manner to pursue the guarantor for any monies outstanding under the documentation governing the transaction. The guarantor may make one lump sum payment of all monies under such documentation to the bank, or the guarantor may assume the future payment obligations of the counterparty covered by the guarantee. The bank must have the right to receive any such payments from the guarantor without first having to take legal actions in order to pursue the counterparty for payment.

ii) The guarantee is an explicitly documented obligation assumed by the guarantor.

iii) Except as noted in the following sentence, the guarantee covers all types of payments the underlying obligor is expected to make under the documentation governing the transaction, for example notional amount, margin payments etc. Where a guarantee covers payment of principal only, interests and other uncovered payments should be treated as an unsecured amount in accordance with paragraph

## Annexure 3

**Extracts from RBI Master Circular – Basel III Capital Regulations – July 1, 2015**

(https://rbidocs.rbi.org.in/rdocs/notification/PDFs/58BS09C403D06BC14726AB61783180628D39.PDF)

7.5.6 Range of Eligible Guarantors (Counter-Guarantors)

Credit protection given by the following entities will be recognized:

(i) Sovereigns, sovereign entities (including BIS, IMF, European Central Bank and European Community as well as those MDBs referred to in paragraph 5.5, ECGC and CGTSI, CRGFTLIH), banks and primary dealers with a lower risk weight than the counterparty;

(ii) **Other entities that are externally rated** except when credit protection is provided to a securitization exposure. This would include credit protection provided by parent, subsidiary and affiliate companies when they have a lower risk weight than the obligor.

(iii) When credit protection is provided to a securitization exposure, other entities that currently are externally rated BBB- or better and that were externally rated A- or better at the time the credit protection was provided. This would include credit protection provided by parent, subsidiary and affiliate companies when they have a lower risk weight than the obligor.

As per Basel III guidelines credit protection given by following entities will be recognized:

- Sovereign entities, PSEs, banks, and securities firms with a lower risk weight than the counterparty
- Other entities that are externally rated except when credit protection is provided to a securitisation exposure. This would include credit protection

provided by parent, subsidiary and affiliate companies when they have a lower risk weight than the obligor

- when credit protection is provided to a securitization exposure, other entities that currently are externally rated BBB- or better and that were externally rated A- or better at the time the credit protection was provided. This would include credit protection provided by parent, subsidiary and affiliate companies when they have a lower risk weight than the obligor.

***<u>Sources:</u>***

*"A global regulatory framework for more resilient banks and banking systems" published by the Basel Committee in December 2010 (revised in June 2011).*

*In a QIS FAQ publication dated December 2002 (Chapter E: Credit Risk Mitigation), the Basel Committee stated that insurance could be used to mitigate credit risk provided it fulfills the operational requirement applicable to guarantees.*