Guidelines on Trade Credit Insurance

December 13 2010

The IRDA issued guidelines on trade credit insurance on 13th December 2010. The guidelines came into force with immediate effect requiring Insurers to file revised products with the IRDA in line with these guidelines and the F&U procedures and norms. All existing credit insurance policies remain valid as per the original contract terms until their expiry.

The key features of the guidelines are:

- Definitions of terms such as buyer, maximum liability, credit limit, insolvency, factoring, etc have been provided along with conditions for premium, claims, IBNR and IBNER reserves to be created on an actuarial basis.

- Trade credit insurance is treated as ‘miscellaneous business’, but is to be reported separately under the financial statement requirements.

- The scope of cover under a trade credit policy has also been provided: The credit risk shall have a direct link with an underlying trade transaction, ie the delivery of goods or services and if no direct link exists, the outstanding amount is not insurable under a trade credit policy. A trade credit policy shall only be issued if all the following are satisfied:

  - The policyholder’s loss is non-receipt of a trade receivable arising out of a trade of goods or services;

  - The policyholder is a supplier of goods or services in consideration for a fair market value;

  - The policyholder’s trade receivable does not arise out of factoring or reverse factoring, bill discounting or any similar arrangement;

  - The policyholder has a Buyer who is liable to pay a trade receivable to the policyholder in return for goods and services received by him from the policyholder in accordance with a policy document filed with the Insurer;

  - The policyholder undertakes to pay premium for the entire policy period;

  - Any other requirement specified by the IRDA from time to time.

- No Insurer shall issue a financial guarantee. A trade credit policy cannot be issued to banks, financial institutions or lenders where they are the beneficiaries/assignees of claim proceeds or when the buyers are governmental/para-govermental agencies, but may be issued to a seller on a whole-turn over basis subject to (a) pre-credit limits for each buyer fixed by the Insurer, and (b) overall policy limits.

- An insurer shall necessarily assess the credit risk of buyers who contribute more than 2% of the overall turnover.

- Every trade credit policy shall contain a subrogation clause and 'no waiver under any circumstances shall be allowed'.

- No single specific trade credit policy (covering only one shipment) can be sold to a prospect. Similarly, no trade credit policy shall be issued if the buyers are very small in number and in any case where there are fewer than 10 buyers.

- A trade credit policy shall not offer indemnity which is more than 80% of the trade receivable of the buyer, or 90% of the cost incurred by the seller for the previous year whichever is lower. Further, an Insurer shall not issue more than one trade credit policy to a policyholder.

- For writing this class of business: (a) Insurers shall have well defined underwriting, risk management and claims settlement guidelines approved by the Board of Directors, (b) qualified, experienced and trained employees, (c) the net retention of the Insurer shall not exceed 2% of its net worth, and (d) Insurers shall appoint with the approval of the Board of Directors a credit management agency (which has no conflict of interest with the policyholder) for assessing the credit worthiness of a policyholder.

- Insurers shall file details of its reinsurance arrangements with the Board of Directors and the IRDA. The reinsurance arrangement is to be appropriately drafted to avoid situations where a Reinsurer may deny liability to pay for a trade credit claim using clauses under the reinsurance agreement instead of under the primary policy.

- The IRDA has the power to inspect, investigate and suspend trade credit insurance business of an Insurer if it is of the opinion that the continued writing of trade credit insurance business is detrimental to the interests of the Insurer or violating IRDA instructions issued from time to time.

For further information on this topic please contact Tuli & Co by telephone

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