

**MINISTRY OF COMMERCE**

**CHAPTER I**

**Export Credit Guarantee Corporation of India Limited**

**Selected guarantee and policy products**

***Highlights***

Export Credit Guarantee Corporation of India Limited (Company) had not prescribed any timeframe for processing the credit limit applications received from banks for export credit insurance. It took more than two months in 14, 9 and 9 *per cent* of cases in 2005-06, 2006-07 and 2007-08 respectively.

***(Para 1.6.1.3)***

There was absence of a system of regular follow up action with banks in respect of claims involving accountability issues.

***(Para 1.6.2.1)***

The Company did not insist on proper verification of the creditworthiness of the foreign buyers by banks where exporters happened to be non-policyholder. The claims were 62 *per cent* (Rs. 61.89 crore) where the creditworthiness of the foreign buyers was either not verified or partially verified.

***(Para 1.6.3.3)***

The Company was not geared to take full advantage of the opportunities presented by the Securitisation and Reconstruction of Financial Assets and Enforcement of Securities Interest Act, 2002 with respect to recovery action. In 67 claims settled for Rs.123.81 crore in 2005-08, no recoveries were effected through banks even though banks held collateral securities of Rs.587.25 crore.

***(Para 1.6.4.4)***

There was an inconsistency in the 'recovery-sharing clause' with regard to the rate of interest on delayed remittance of recoveries by banks and non-recovery of interest from banks. In six cases, the Company did not levy interest even on receipt of late payments.

***(Paras 1.6.5 and 1.6.5.6)***

The Company settled Shipment (Comprehensive Risks) Policy (SCR) claims without obtaining customs certified documents to confirm that exports had actually taken place.

***(Para 1.7.1)***

The Company permitted the extension of insurance coverage without advance deposit of premium thereby violating the requirements of the Insurance Act, 1938.

***(Para 1.7.2.4)***

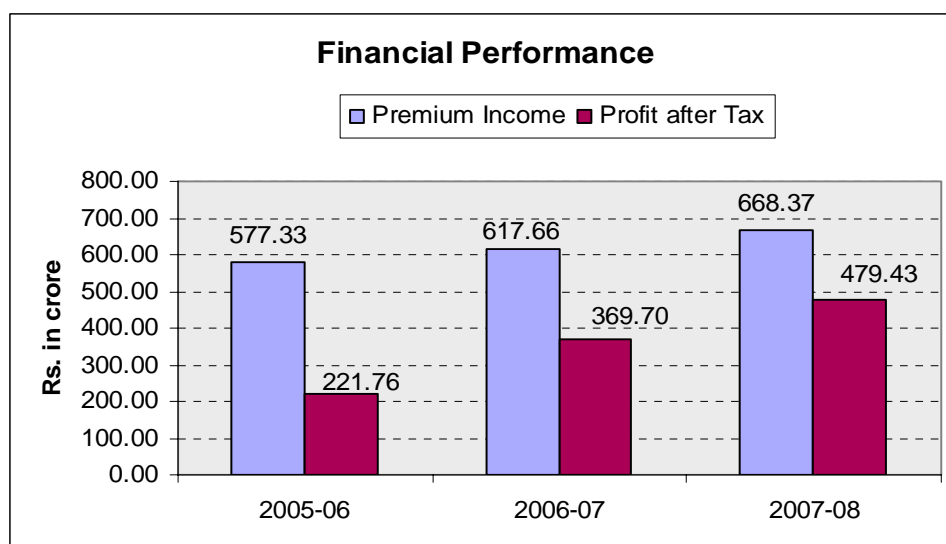
The Company incurred avoidable claim payments of Rs.16.13 crore under SCR policies due to non-cancellation of overall limit on buyers despite adverse reports of credit information agencies.

(Para 1.7.3)

### 1.1 Introduction

In order to provide export credit insurance support to Indian exporters, the Government of India set up the Export Credit Guarantee Corporation of India Limited (Company) in July 1957<sup>1</sup> under the administrative control of the Ministry of Commerce. As on 31 March 2008, the paid-up capital of the Company was Rs.900 crore. Since 2000-2001, the Company has been signing MOU with its administrative Ministry and was graded “excellent” in 2005-06 and 2006-07 by the latter. Its profit after tax was Rs.221.76 crore in 2005-06 which increased to Rs.369.70 crore in 2006-07 and further to Rs.479.43 crore in 2007-08 as can be seen from the chart below.

Chart 1.1



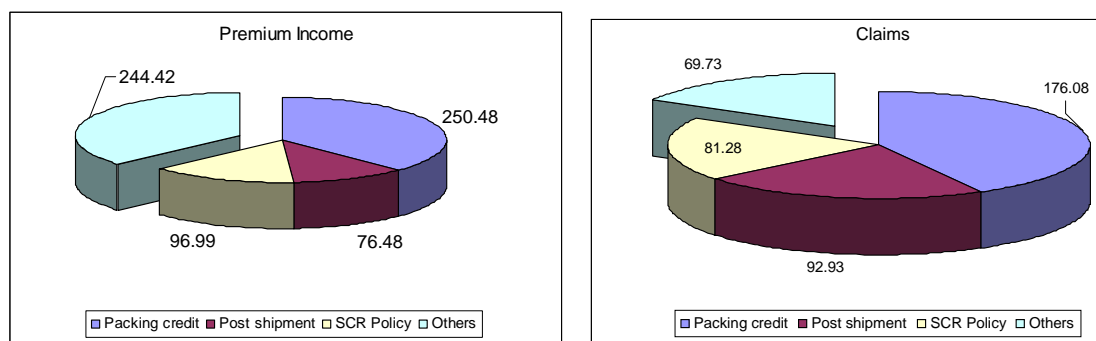
The Company provides a range of risk insurance covers to exporters against loss in export of goods and services; offers guarantees to banks to enable exporters to obtain better facilities from them; provides overseas investment insurance to Indian companies investing in joint ventures abroad in the form of equity or loan. It offered these services through 31 types of guarantees and policy products under five sectors as detailed in *Annexure-I* and had 97 brokers, 25 agency agreements with commercial banks and a tie up with the National Small Industries Corporation Limited to market them as of June 2008. The organisation insured business of Rs.4,37,882.88 crore, Rs.4,28,840.80 crore and Rs.9,22,183.08 crore in 2005-06, 2006-07 and 2007-08 respectively.

<sup>1</sup> Originally known as the Export Risks Insurance Corporation Private Limited in 1957; later changed to Export Credit & Guarantee Corporation Limited in 1964 and finally in 1983, to Export Credit Guarantee Corporation of India Limited.

## 1.2. Scope of Audit and coverage

Performance audit was carried out of the Company's business covering the period 2005-06 to 2007-08 pertaining to three products (i) Export Credit Insurance guarantee<sup>2</sup> for Banks (ECIB)-Whole Turnover Packing Credit<sup>3</sup>(Packing Credit), (ii) ECIB-Whole Turnover Post Shipment<sup>4</sup> (Post Shipment Insurance) and (iii) Shipment (Comprehensive Risks) Policy<sup>5</sup> (SCR). These three products represented 63.43 per cent of the premium income and 83.40 per cent of claims paid by the Company in 2007-08 as shown in the chart below:

**Chart 1.2**



### 1.2.1 Performance of the products

Table given below shows the performance of the products in 2007-08.

**Table 1.1**

	Premium income	Claims	Recoveries	Claims to premium ratio	Recoveries to claims ratio
	Rs. in crore			In percentage	
<b>Packing credit</b>	250.48	176.08	93.45	70.30	53.07
<b>Post shipment</b>	76.48	92.93	35.01	121.51	37.67
<b>SCR Policy</b>	96.99	81.28	5.43	83.80	6.68
<b>Others</b>	244.42	69.73	23.14	28.53	33.19
<b>Total</b>	<b>668.37</b>	<b>420.02</b>	<b>157.03</b>	<b>62.84</b>	<b>37.39</b>

A higher percentage of claims to premium income points towards poor performance of a product. A high percentage of recovery to claim is a measure of effectiveness of the recovery mechanism. It would be seen from the preceding table that the claim ratio was

<sup>2</sup> Guarantees are contracts between the Company and banks to protect the latter against the risk of insolvency or protracted default of/by the exporter to pay amounts due to a bank.

<sup>3</sup> Packing Credit (PC) refers to any loan, advance or credit granted by a bank to an exporter for financing the purchase, manufacturing, or packing of goods prior to shipment.

<sup>4</sup> Post Shipment credit is any loan, advance or credit granted by a bank to an exporter of goods or services from India after shipment of goods or rendering of services to the date of realisation of export proceeds.

<sup>5</sup> Shipment (Comprehensive Risks) Policy is a cover issued for two years by the Company directly to an exporter whose anticipated export turnover for the next 12 months is more than Rs. 50 lakh, to cover commercial and political risks in respect of goods exported on short-term credit not exceeding 180 days.

highest in post shipment guarantees at 121.51 *per cent* against the average of 62.84 *per cent* indicating poor performance of the scheme. The lowest percentage of recovery to claim at 6.68 *per cent* in SCR Policies against the average of 37.39 *per cent* signified a weak recovery system.

### **1.3. Audit objectives**

The performance audit of the three selected products-the packing credit, the post shipment guarantee for banks and SCR policy was conducted with the objective of identifying systemic and compliance issues relating to the procedure of sanctioning, evaluation of creditworthiness of foreign buyers/exporters, settlement of claims, system and effectiveness of recovery action.

### **1.4. Audit methodology and sample**

The performance audit was carried out through scrutiny of records, policies, guarantees and claims for the three years 2005-06 to 2007-08 at the Company Head office in Mumbai, three of the six<sup>6</sup> Bank Business Branches (BBB) in Delhi, Kolkata and Mumbai (Nariman Point) and five of the 43 Exporters Branch Offices (EBO) in Chennai, Delhi, Kolkata, Mumbai and Bangalore. The sampling method adopted is detailed at **Annexure-II**. In all, Audit reviewed 223 guarantees, 122 claims for Rs.239.13 crore, 305 SCR policies and 70 SCR claims for Rs.26.25 crore.

The Entry conference with the Management was held on 8 May 2008. Preliminary audit observations were issued to the Company on 21 August 2008 to which a formal response was received on 29 August 2008. The Exit conference was held with Management on 4 September 2008. The audit observations detailed in the succeeding paragraphs were finalised in the light of the formal response and discussions with the Management. The Ministry sent its comments on 2 January 2009. The viewpoint of the Ministry and the Company has been considered and included appropriately at the time of finalisation of this report.

### **1.5. Acknowledgement**

Audit acknowledges the cooperation and assistance extended at different levels of the organisation, which facilitated the completion of this performance audit within the set timeframe.

### **1.6 Audit findings – Packing credit and post shipment guarantees for banks**

#### **Systemic issues**

#### **1.6.1 Absence of a timeframe to grant credit limit approval under the packing credit and post shipment guarantee for banks**

**1.6.1.1** As per the Company's policy, banks have unlimited powers to sanction credit limits to existing exporter clients with standard rating. In case of new clients, however, banks have to obtain the Company's approval to grant a credit limit to any exporter, if it exceeds the 'Discretionary Limit'<sup>7</sup>(DL) fixed by the Company for that bank. For obtaining an approval of the credit limit, the bank has to submit, within 60 days from the

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<sup>6</sup> *Bank Business Branches at (i) Bangalore, (ii) Chennai, (iii) Delhi, (iv) Kolkata, (v), Mumbai (Nariman Point), and (vi) Mumbai (Bandra)*

<sup>7</sup> *'Discretionary Limit' is the limit fixed by the Company in respect of each bank upto which the bank can grant advances to each new client without the Company's approval.*

date of sanction of that limit by the bank, an application to the Company in respect of the new exporter as per clause 6(1)(b) of the standard agreement between the Company and banks. The bank, however, is at liberty to make credit advances to the exporter pending receipt of approval from the Company – in such a situation, the Company's claim liability is limited only to the extent of the amount of the DL fixed for that bank.

**1.6.1.2** Audit observed that although the banks had a 60-days deadline within which to submit their applications, the Company was not bound by any reciprocal obligation to convey its approval/disapproval. An analysis of the time taken by the Company in this regard revealed the following:

Table 1.2

Year		2005-06	2006-07	2007-08
No. of applications received by the Company during the year		667	415	458
Time taken by the Company to convey approval/disapproval to banks	Within 2 months	576	378	418
	> 2 months < 6 months	65	30	35
	>6 months < 12 months	21	03	05
	> 12 months	05	04	-

**1.6.1.3** It would be seen that the time taken by the Company to communicate its decisions to banks during 2005-06, 2006-07 and 2007-08 was more than two months in 14, 9 and 9 per cent cases respectively.

**1.6.1.4** Further, the intention of the Company to limit its claim liability to the extent of the DL fixed for each bank was not served and the grant of the approvals appeared to be a mere formality as illustrated in the following cases where the bank granted advances without the approval of the Company and upon default, the Company had to pay out even though the credit limit was not sanctioned or sanctioned after the payment of advance by the bank:

(i) Central Bank of India, in August 2003 applied for a credit limit approval of Rs. seven crore in favour of West Bengal Essential Commodity Supply Corporation Limited (WBECSC). Although the application was acknowledged by the Company in September 2003, no approval was communicated to the Bank. The latter granted advances to the WBECSC during February 2004 to February 2005 totalling Rs.5.89 crore, without the approval of credit limit by the Company. Subsequently, when it preferred claims in November 2007 against these advances, the Company made a claim payment of Rs. 3.83 crore in February 2008.

(ii) Syndicate Bank applied to the Company in April 2005 for a credit limit of Rs.100 crore in favour of the WBECSC which was approved in May 2006. In the meantime, the bank granted an advance of Rs.5.88 crore in May 2005 to the WBECSC against which a claim arose in October 2007 and was settled for Rs.3.66 crore by the Company in January 2008.

**Recommendation No.1.1**

***The Company should set itself a timeline for processing credit limit applications received from banks.***

The Ministry stated (January 2009) that the Company had accepted the suggestion and would implement the recommendation effective 1 April 2009 after making necessary changes in its IT systems.

***1.6.2 Follow up of claims involving accountability issues under the packing credit and post shipment credit guarantees***

***1.6.2.1*** As per the claim settlement procedure prescribed by the Company, the bank is required to submit along with a claim form, 19 other documents of which one is a 'Staff Accountability Report' (SAR). The SAR, the format of which is prescribed by the Company, is a certification with two options *viz.*, (a) that there has been no act of commission or omission on the part of the bank officials in causing loss to the bank which ultimately resulted in the bank invoking the Company cover; or (b) in respect of the claim preferred to the Company the bank has made an internal enquiry/matter is under investigation by external agencies (CBI, Enforcement Directorate, *etc.*) and in the event of any of the bank officials being held guilty of *malafide* negligence or irregularity in causing loss to the bank either in the internal/external enquiry, the bank unconditionally agrees to refund the entire amount of claim received to the Company within 30 days. One of these options is to be ticked and the SAR is necessarily to be signed off by an officer of the rank of General Manager of the claimant bank.

***1.6.2.2*** All claims where the second option is marked in SAR are required to be forwarded to the Company's Head Office for a decision at the level of General Manager and above only.

***1.6.2.3*** It was observed that the Company did not monitor on a regular basis nor did it have a ready list of such cases. In the absence of any such list it was not clear as to how the organisation was keeping track of the progress and/or final outcome of the investigations and its receivables, if any, emanating from these proceedings.

***1.6.2.4*** In one case noticed, the Company settled a claim for Rs.67.32 lakh in March 2006 with the Development Credit Bank Limited (DCBL) even though DCBL established that its Zonal Chief committed negligence (as a result of which he was asked to leave the bank) in accepting a loss making company with weak financials, enhancing exposure by more than 75 *per cent* within 15 months in spite of being aware of irregularities in the maintenance of stocks and not undertaking security protection to secure the advances by collateral securities.

**Recommendation No. 1.2**

***The Company should institute a system of regular in-house consolidated reporting and follow up of claims involving accountability issues besides ascertaining its dues, if any, arising out of such cases.***

The Ministry stated (January 2009) that the recommendation had been accepted by the Company and necessary change would be made effective 1 April 2009 after making the necessary modifications in its IT systems.

### **1.6.3 Inadequate verification of creditworthiness of importers**

**1.6.3.1** The post shipment credit guarantee issued by the Company to the insured banks covers advances given by banks to two categories of exporters viz., policyholders and non-policyholders.

**1.6.3.2** A policyholder is an exporter who already has another existing one-on-one policy cover with the Company. In this case the Company carries out a creditworthiness verification<sup>8</sup> of the buyers involved i.e., importers, before the policy is given, to reduce the risks of claims arising.

**1.6.3.3** For non-policyholders, however, the Company does not make it incumbent on banks to verify buyers' creditworthiness. This is a lacuna that requires to be addressed as there has been a greater number of claims from non-policyholders vis-à-vis policyholders. Of the 48 post shipment guarantee claims<sup>9</sup> paid during 2005-06 to 2007-08 totalling Rs.99.30 crore by Kolkata, Delhi and Mumbai BBBs seen in audit, it was found that:

- (i) only 16 claims paid pertained to policyholders;
- (ii) 32 claims for Rs.61.89 crore (62 per cent) pertained to exporters who were non-policyholders.

**1.6.3.4** In respect of the latter 32 claims, it was further seen that:

- (i) in nine claims totalling Rs.9.60 crore, the banks had not carried out creditworthiness verification of the foreign buyers nor was this condition stipulated in the sanction terms of the concerned banks in six out of the nine cases;
- (ii) in five claims totalling Rs.16.77 crore, the banks had only partially carried out verification of 23 out of the 40 importers involved;
- (iii) in the remaining 18 cases, full verification of the importers was carried out;
- (iv) of the 23 cases where partial/full verification was carried out, in respect of 11 importers forming part of seven claims paid totalling Rs.24.72 crore, the dates of the verification had no relevance to the period of the advances given by the banks.

#### **Recommendation No. 1.3**

***To reduce the risk of claims, the Company should make it mandatory for banks to carry out creditworthiness verification of foreign importers before sanctioning advances to an exporter under the post shipment credit guarantee.***

The Ministry stated (January 2009) the recommendation had been accepted by the Company and the necessary condition would be laid down by the Company for verification of importers' credit worthiness, effective 1 April 2009.

<sup>8</sup> Creditworthiness of the buyer is ascertained by the Company from credit reports obtained from specialised agencies.

<sup>9</sup> Sample size on the basis of sampling method adopted.

**1.6.4 Securitisation and Reconstruction of Financial Assets and Enforcement of Securities Interest Act, 2002 – impact on the Company**

**1.6.4.1** The Securitisation and Reconstruction of Financial Assets and Enforcement of Securities Interest (SARFAESI) Act, 2002 empowers banks to recover their dues by disposing off defaulters’ properties lodged with them as securities.

**1.6.4.2** The recovery performance under the ‘Guarantees - Short Term Exports’ sector in the 31 years (April 1971 to March 2002) before the enactment of the SARFAESI Act and in six years (April 2002 to March 2008) post-SARFAESI, was as under<sup>10</sup>:

**Table 1.3**

*(Rupees in crore)*

<b>Period</b>	<b>Claims paid</b>	<b>Recoveries effected</b>
April 1971 to March 2002	901.55	92.56
April 2002 to March 2008	1804.25	558.34

The percentage recoveries effected to claims paid was 10 and 31 in the pre-SARFAESI and post-SARFAESI periods respectively.

**1.6.4.3** The onus of recovery action against individual exporters with respect to packing credit and post shipment credit guarantees under the ‘Guarantees - Short Term Exports’ sector, lies with banks. However, the Company is a definite beneficiary arising out of any successful efforts by banks on this count. It is, therefore, expected that the Company take on a proactive role in urging banks to escalate recovery action. This, however, did not appear to be the case.

**1.6.4.4** Of the 122<sup>11</sup> claims paid totalling Rs.239.13 crore under the packing credit and the post shipment credit guarantees during 2005-06 to 2007-08 in the three selected BBBs seen in audit, 67 claims were settled for Rs.123.81 crore. Against none of these claims paid out did any related recoveries accrue to the Company although records available with the Company showed that banks held collateral securities worth Rs.587.25 crore in these cases. Despite possessing this information, it did not make any extra efforts to urge banks to initiate recovery action under the SARFAESI Act apart from issuing routine letters to them.

**1.6.4.5** Thus, while the SARFAESI Act has significantly achieved its objective of enabling banks to take effective action to recover their dues because of which the Company had also benefited, the Company on its part was yet to be geared upto take full advantage of the opportunities presented by the situation.

**Recommendation No. 1.4**

***In consultation with banks, the Company should evolve a strategy to escalate recovery action under the SARFAESI Act.***

<sup>10</sup> The Company being an insurance company does not come within the purview the SARFAESI Act. It cannot therefore, take recourse to this Act to initiate recovery action in respect of policies extended by it under the ‘Standard Policies and Transfer Guarantees’ sector.

<sup>11</sup> Sample size on the basis of sampling method adopted.

The Ministry stated (January 2009) the Company had intimated that they would consult banks and explore possibilities of accelerating recovery action in consultation with banks. Depending on the outcome, a strategy would be evolved by the Company.

### **Compliance issues**

#### **1.6.5 Inconsistency in recovery sharing clause and non-recovery of interest from banks**

**1.6.5.1** Clause 13 of Part-III of the Packing Credit Operational Guidelines issued by the Company to banks stipulates that all amounts recovered by a bank, after payment of claims by the Company, are to be promptly shared between the two in the ratio in which the loss was shared. A delayed payment by the bank beyond 30 days from the date of recovery entitles the Company to claim interest at five *per cent* over the Bank Rate.

**1.6.5.2** However, clause 4(b) of the proposal form (format prescribed by the Company) needed to be submitted by a bank at the time of new guarantee/renewal of an existing guarantee states that the bank undertakes to pay to the Company its share of any recoveries made by the bank within seven days of effecting such recoveries and in the event of delay, interest at the prevailing Bank Rate will be charged for the delayed period.

**1.6.5.3** The inconsistencies between the two aforementioned clauses need to be remedied.

**1.6.5.4** In case of recoveries made by banks under the post shipment credit guarantee, interest is chargeable at five *per cent* over the bank rate for any delay in excess of seven days from the date of recovery by the bank.

**1.6.5.5** During 2005-06 to 2007-08, of the 122<sup>12</sup> packing credit and post shipment guarantee claims paid by Kolkata, Delhi and Mumbai BBBs seen in audit, recoveries were effected by banks in 34 instances with the Company getting Rs.24.55 crore as its share of the recoveries. It was noticed that in three instances the banks had remitted the Company's share promptly. In 25 out of the remaining 31 cases, banks had not notified the Company of the recovery dates nor were they asked to. Neither had the Company claimed any interest on delayed payments in these cases.

**1.6.5.6** In four instances relating to the packing credit guarantees where dates were available, the interest that ought to have been charged by the Company, but not collected, was Rs.2.05 lakh calculated by the first method. In the two cases relating to the post shipment credit guarantees, interest worked out to Rs.3.37 lakh.

**1.6.5.7** Audit observed that the Company was not in a position to keep track of its share of recoveries and/or to claim interest on delayed payments, as banks were not bound to report the dates on which the recoveries were made. Currently, banks through routine letters remit the Company's share of recoveries by bank drafts/cheques. Recoveries under the packing credit and the post shipment credit together constituted 69 and 82 *per cent* of the Company's total recoveries in 2006-07<sup>13</sup> and 2007-08 respectively. Given these numbers it is necessary that a standardised letter be prescribed by the Company for use by banks so as to enable the former to keep track and verify that it receives its correct share of recoveries and interest due, if any. The letter, should *inter alia* include details of

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<sup>12</sup> *Sample size on the basis of sampling method adopted.*

<sup>13</sup> *Figures for 2005-06 not available as product-wise details were not maintained by the Company.*

claim number, name of exporter, date/month/amount of claim settled, date of recovery/amount recovered by bank and the Company's share, date of remittance by bank, number of days delay beyond due date, interest calculated/paid to the Company for delay, etc.

***Recommendation No. 1.5***

***The Company should prescribe a standardised format of the communication under which banks should remit cheques/bank drafts of its share of recoveries to its offices.***

The Ministry stated (January 2009) that the recommendation to prescribe a standardised format of communication under which banks would remit their share of recoveries had been accepted by the Company and steps were being taken by the Company to standardise the recovery sharing clause.

***1.7. Audit findings- SCR Policy***

The SCR policy is a credit insurance policy meant for goods exported on short term credit not exceeding 180 days. It covers individual exporter's risk upto 90 *per cent* against commercial and political risk from the date of shipment and is issued to exporters whose anticipated turnover for the next 12 months is more than Rs.50 lakh. It covers all shipments made by an exporter during 24 months from the issue of the policy subject to sanction of a credit limit on the foreign buyer by the Company in favour of the policyholder. A review of sanction procedures prescribed for sanctioning and 305 SCR policies issued during 2005-06 to 2007-08 revealed the following:

***Systemic issues***

***1.7.1 Settlement of claims without obtaining proper documents***

***1.7.1.1*** A claim form<sup>14</sup> under an SCR policy is to be submitted along with the following nine documents:

- i) Contract/Order
- ii) Invoice
- iii) Bill of Lading/Airway Bill
- iv) Non-payment advice from the foreign bank
- v) Original unpaid accepted Bill of Exchange
- vi) In respect of open delivery claims, proof of delivery from airline/ shipping /cargo companies and confirmation from the buyer that he has taken delivery
- vii) Protest note
- viii) Correspondence with original buyer
- ix) Statements of exports made to all buyers in last two years prior to the first shipments in default, giving date of shipment, GR No., Gross Invoice value, terms of payment, amount realised and date of realisation.

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<sup>14</sup> *The Company's Circular No. 105 dated 6 February 2004.*

A check of 70 claims<sup>15</sup> settled under the SCR policy in Kolkata, Bangalore, Chennai, Delhi and Mumbai EBOs disclosed that claims were settled without receiving the prescribed documents as detailed below:

- (i) in 18 cases, the exporters while preferring the claims had not submitted the accepted original Bill of Exchange (BOE); however, the Company admitted and settled these claims to the tune of Rs.5.04 crore by condoning this lapse;
- (ii) in 69 cases the BsOE were unstamped although exporters are required to affix stamps of the mandatory value in accordance with the Indian Stamp Act, 1899; and
- (iii) in 18 cases, claims settled for Rs.5.85 crore were preferred either by submitting proforma invoices (12 claims) or without the required contract or purchase order (six claims).

The Company condoned<sup>16</sup> non- submission of an accepted BOE as a non-serious (category 'C') lapse. This is not in order as in the absence of an accepted BOE, admission of liability by the buyer (importer) cannot be established. Therefore, the legal options available to the Company against the buyer to enforce- recovery would be limited. The instances of the 69 unstamped BsOE leads to the question whether the documents can technically and legally be considered as acceptable.

As per clause 3 of the terms and conditions of the SCR policy, the policy shall apply to all shipments of goods made by the insured pursuant to any contract or agreement. A contract or agreement must, therefore, exist for every shipment under an SCR policy and its submission along with the claim should hence be insisted upon by the Company. A proforma invoice cannot be substituted for a contract or purchase order as this document will contain additional vital information such as schedule of shipment, procedure of quality inspection, weighment, packing, etc. The contract or purchase order is also essential for the Company to determine the validity of the claim with reference to the excluded risks covered under clauses 1(a)(iii), 2 and 5(a) of the SCR policy. Here again, the Company had categorised this lapse on the part of the exporter as a condonable category 'C' lapse.

**1.7.1.2** Audit observed that none of the above nine documents required to be submitted by an exporter along with the claim form were papers endorsed by the customs authorities in the absence of which, the fact that actual exports had taken place could not be vouchsafed with absolute certainty. To establish the genuineness of a claim, it is suggested that the Company prescribe the additional following customs cleared documents for submission by an exporter with the claim:

**Table 1.4**

<b>Sl. No.</b>	<b>Document recommended</b>	<b>Remarks</b>
1	Export Promotion copy of the Shipping Bill	This is a copy of the Shipping Bill that is endorsed by the customs authorities and returned to the exporter. It contains important details of the shipment viz, full details of shipment, consignment value, Purchase Order No., reference to Mate

<sup>15</sup> *Sample size on the basis of sampling method adopted.*

<sup>16</sup> *The Company's Circular No. 204 dated 24 September 2007.*

Sl. No.	Document recommended	Remarks
		<p>Receipt (an acknowledgement issued by an officer of a ship/airline that goods have actually been taken on board) No., etc.</p> <p>Para 4 .8 of the 'Handbook of Procedures' (Vol.-I) brought out by the GOI, Ministry of Commerce and Industry, Department of Commerce states that in the case of gem and jewellery exports, the "exporter has to furnish the Export Promotion copy of the Shipping Bill as the proof of exports whenever required".</p> <p>The Export Promotion copy of the Shipping Bill is common for all exports. It can, therefore, be prescribed by the Company for submission by an exporter as definitive proof of export.</p>
2	<p>Statutory Declaration Form (SDF) – In case of Shipping Bill processed electronically by Customs</p> <p style="text-align: center;"><i>Or</i></p> <p>Exchange Control Declaration (Guaranteed Receipt -GR) Form - In case of Shipping Bill processed manually by Customs</p>	<p>The form contains reference to the Shipping Bill, declaration of full export value and name of the bank and the branch through which the foreign exchange is to be received. This form is required to be submitted by the exporter under the Foreign Exchange Management Act, 1999 to the customs authorities who return it to the exporter after verification/cross check with other documents.</p> <p>This is a detailed form containing all particulars of the export shipment and required to be submitted by the exporter to the customs authorities under the Foreign Exchange Management (Export of goods and services) Regulations, 2000. After duly verifying and authenticating the form, the customs forwards the original declaration form to the RBI and the duplicate copy to the exporter. The customs give their running serial number - denoting the code number of port of shipment, calendar year and six-digit running serial number, on the copies of the form.</p>

**Recommendation No. 1.6**

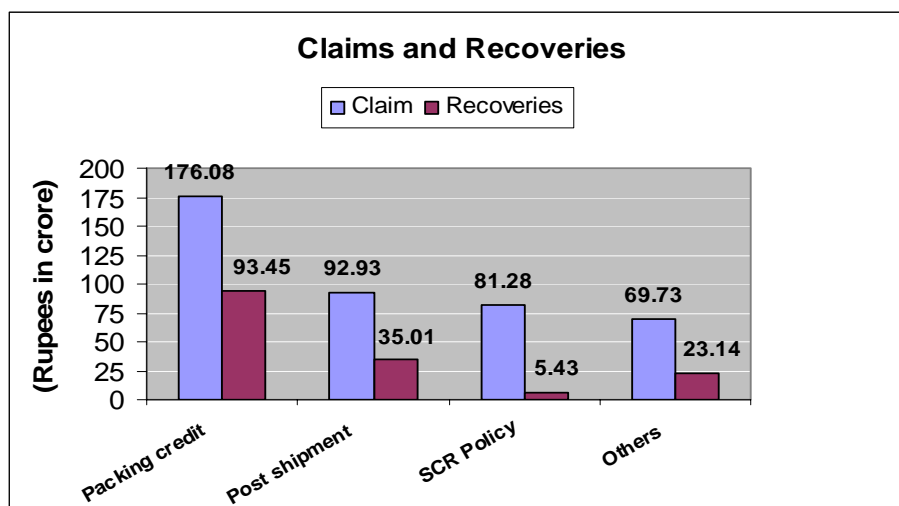
***The Company should require the above two documents, in addition to the nine already prescribed, to be submitted by an exporter along with a claim form under the SCR policy.***

The Ministry stated (January 2009) that the Management had accepted (August 2008) the recommendation and necessary instruction had been issued by the Company to implement the suggestion.

**Compliance issues**

The following pictorial shows the percentage of the recoveries to claims, which is a measure of the effectiveness of the recovery system, in 2007-08

Chart 1.3



The figures show poor performance of the recovery system in SCR policy *vis-à-vis* guarantees and other products of the Company.

**Recommendation No.1.7**

***The Company should strengthen the recovery system in SCR policies.***

**1.7.2 Violation of the Insurance Act, 1938**

**1.7.2.1** The Company was registered as an insurance company in September 2002 and was, therefore, governed by the provisions of Insurance Act, 1938. Section 64 VB of the Act enjoins that no insurer shall assume any risks in India in respect of any insurance business unless and until the premium payable is received in advance. This condition was also incorporated as clause 10(b) of the Company's SCR policy document.

**1.7.2.2** The Company's Board on 31 May 2005 approved the collection of advance premium for SCR policies and Small Exporters (SEP) policies with effect from 1 September 2005. Following this, the Company in August 2005<sup>17</sup> decided that the collection of advance premium would be effective for policies issued/renewed or in force from/on 1 September 2005. Branch offices were to collect advance premium based on export projections of the exporter subject to a minimum of Rs.10,000 and Rs.2,000 for every SCR and SEP policy respectively.

**1.7.2.3** In July 2006<sup>18</sup> it was decided that till policyholders became acquainted with the new system, the old system of payment of premium was to be allowed till 31 August 2006 and this arrangement would be reviewed in August 2006. In September 2007<sup>19</sup>, the Company issued revised guidelines allowing time extension for another two years on the same grounds.

**1.7.2.4** Under the old system *i.e.* prior to 1 September 2005, the Company collected a minimum premium of Rs.10,000 at the time of issue of an SCR policy while the actual

<sup>17</sup> The Company's Circular No. 137 dated 02 August 2005

<sup>18</sup> The Company's Circular No. 172 dated 20 July 2006

<sup>19</sup> The Company's Circular No 204 dated 24 September 2007

premium for each shipment was made subsequent to the date of shipment, by the 15<sup>th</sup> day of each month for all shipments made during the previous month. Thus, in cases where the actual premium payable by an exporter for a shipment or shipments during a particular month exceeded Rs.10,000, the exporter was allowed time upto the 15<sup>th</sup> of the following month to pay the differential - on the other hand, the Company had already assumed the risks from the date of each export shipment. This situation violated a fundamental tenet of the insurance business *viz.*, that no insurer shall assume any risk unless and until the premium payable is received in advance – a principle laid down in the Insurance Act, 1938 as well as by the Company itself in the SCR policy document.

**Recommendation No. 1.8**

***The Company being an insurance company is required to operate within the purview of the Insurance Act, 1938. Any divergence therefrom is legally untenable. As such it is suggested that no further extension of time be allowed to exporters beyond September 2009 to comply with the provisions relating to payment of advance premium under the SCR and SEP policies.***

The Ministry stated (January 2009) that the Company had amended the relevant clause of the SCR policy document and guidelines had been issued by the Company to treat the non-compliance of the above requirement as a lapse to be examined at the time of claim.

***1.7.3 Avoidable claim payments of Rs.16.13 crore under SCR policies due to approval/enhancement/non-cancellation of overall limit on importers despite adverse reports of credit information agencies***

***1.7.3.1*** Overall Limit (OL) is the maximum limit fixed by the Company on a particular buyer (importer) upto which it may consider the claim in the event of loss for one or more policyholders (exporters) under one or more types of policies falling under the sector ‘ Standard Policies and Transfer Guarantees’. As per the Company’s procedures<sup>20</sup>, reports of specialised credit information agencies<sup>21</sup> on a particular buyer is an important input based on which the decision to fix/review an OL for a particular buyer is taken. A check of 70<sup>22</sup> SCR policy claims paid during 2005-06 to 2007-08 in five selected EBOs showed that serious adverse remarks on buyers by credit information agencies in two cases, both pertaining to the Mumbai EBO, were ignored resulting in the Company settling avoidable claims of Rs.16.13 crore, as narrated below:

(a) A claim settlement of Rs.2.43 crore was made in October 2005 to an exporter M/s Dinurejee against an SCR policy for losses suffered on account of a buyer’s, M/s Friedman’s Inc. USA, failure to pay for five shipments made between 8 November 2004 and 30 December 2004.

The Company also settled five more claims amounting to Rs.11.73 crore, as detailed below, of other exporters for shipments made between October 2004 and January 2005 to the same buyer *i.e.* M/s. Friedman’s Inc. USA.

<sup>20</sup> *Paras 9.20 to 9.22 of the Company’s Policy Planning Department Circular No. 115 dated 5 July 2004*

<sup>21</sup> *M/s. Dun & Bradstreet India and M/s Mira Inform Pvt. Ltd. are the credit information agencies whose services are utilised on a regular basis by the Company.*

<sup>22</sup> *Sample size on the basis of sampling method adopted.*

**Table 1.5**

<b>Sl. No.</b>	<b>Exporter</b>	<b>Shipment months</b>	<b>Claims paid (Rs. in crore)</b>	<b>Date of payment</b>
1	C. Mahendra Infojewel	November and December 2004, January 2005	7.74	29 March 2006
2	Saunay Jewels Pvt. Limited	November and December 2004	1.96	29 March 2006
3	Shankar Jewels Limited	November and December 2004	0.90	6 September 2005
4	Diam Star Jewellery (India) Pvt. Limited	October, November and December 2004	0.87	6 June 2005
5	C. Mahendra Infojewel	November and December 2004, January 2005	0.26	31 March 2006
<b>Total</b>			<b>11.73</b>	

It was observed that the Company fixed an OL of Rs 20 crore on M/s. Friedman's Inc. USA on 22 November 2003 based on the September 2003 report of M/s. Dun & Bradstreet India (D&B). The Company doubled the OL to Rs.40 crore on 4 December 2003 and again to Rs.50 crore on 29 May 2004 without waiting for a satisfactory experience of the buyer's bona fides or without carrying out further credit checks.

On 25 November 2004, the OL was further enhanced to Rs.70 crore despite the Company receiving adverse reports on the buyer from D&B on 16 September 2004 and from Mira Inform Pvt. Ltd. on 10 November 2004. The negative remarks in these two reports concerned the restatement of financial statements for three previous years, absence of rating, default under credit agreement, withdrawal of audit opinion by auditors on the previously filed annual financial statements, closure of 50 to 65 of the buyer's stores and class action suit against the buyer alleging securities fraud. The failure to take note of these observations, which would have led to cancellation/suspension of the OL on the buyer from October 2004 (after receipt of D&B's report in September 2004), resulted in the Company having to pay out Rs.14.15 crore as claim settlement on account of defaults by M/s Friedman's Inc. USA.

(b) Based on D&B's credit report of April 2003, the Company fixed an OL of Rs. four crore on 9 April 2003 on a buyer, M/s. Cheminter, S.A. Paraguay. Citing the same D&B report, this was raised to Rs. five crore on 19 June 2003. Against this OL, Hetero International Ltd and BDR Pharmaceuticals International Pvt. Limited, made exports to the buyer valuing Rs.1.35 crore and Rs.1.37 crore respectively between 13 June 2003 and 20 August 2003. The buyer failed to make the requisite payments for which both exporters filed claims which were settled by the Company for Rs.1.98 crore (Hetero International Ltd for Rs.75 lakh in June 2005 and BDR Pharmaceuticals International Pvt. Limited for Rs. 1.23 crore in July 2005).

Audit observed that the D&B report of April 2003 had clearly stated that the buyer's "economic and financial cannot be determined" as his payments, financial position, sales, trend, history, balance sheet and/or accounting figures were "not evaluable",

“undetermined” or “incomplete”. The Company’s decision in the first place to grant an OL of Rs. four crore to the buyer was, therefore, unjustifiable and subsequently raising it to Rs. five crore within three months based on the basis of the same D&B report, inexplicable. Had the OL not been allowed to M/s. Cheminter, S.A. Paraguay, the Company would not have found itself in a situation of paying claims totalling Rs.1.98 crore.

The Company with respect to the first case replied (August 2008) that though there were few negative features it was decided to continue to underwrite the business taking into consideration the past payment experience of the buyer. It further stated that the buyer had not gone out of business nor the non-payment had arisen due to bad/*malafide* intention of the buyer.

In the face of the very serious and adverse nature of the information about the buyer, M/s Friedman’s Inc. USA, provided to the Company by both the credit rating agencies, the reply of the Company was unacceptable. Further, in response to another audit observation, the Company stated that caution was exercised in some countries and precaution was taken in case of commodities with adverse claim ratio. Audit observed that though the list included the country of export and the commodity, the credit limit was extended even after receipt of adverse financial report indicated that such caution and precaution were not exercised in this case.

The Company did not respond with respect to the second case.

***Recommendation No. 1.9***

***The Company should require its Buyer Underwriting Department (BUD) to devise and implement a system of assigning pre-determined weights to various parameters (credit rating agency reports, buyer history, track record of the Company with the buyer, etc) that are taken into account in proposing an OL for a particular buyer. This would facilitate BUD to submit an objective review note to the Management for taking a transparent and balanced decision while approving/enhancing the OL of a buyer.***

The Ministry stated (January 2009) that the Company had initiated steps to strengthen the buyer underwriting department and a system generated office note for fixation/enhancement of overall limit was also being introduced.

***1.8 Conclusion***

***1.8.1*** The Company has to play a more active role in carrying out background commercial and financial checks of exporters/importers, a task currently largely left to banks. This would help in further bringing down the level of claims. It should increase its share of recoveries by urging banks to take action under the SARFAESI Act and regular follow up on this matter.

***1.8.2*** The Company should ensure that it functions within the statutory provisions of the Insurance Act, 1938 in relation to its SCR and SEP policies business. It should require exporters to submit additional documentation while submitting claims and for banks to carry out credit worthiness checks of exporters. The Company should also give due and timely emphasis to reports of credit information agencies.