

## Chapter 3

# Short Term Policies issued to Exporters

### 3.1 Short term policies

Policies issued to the exporters covering goods exported on short term credit basis i.e. credit not exceeding 180 days are short term policies. These policies cover export transactions against payment and political risks. Payment risks, also known as commercial risks covered insolvency of the buyer, failure of the buyer to pay within four months after due date of payment (default of buyer), failure or refusal of the buyer to accept the goods, which had already been exported (repudiation of contract) etc. whereas political risks included imposition of restrictions on transfer of payments by buyer's country, occurrence of war between buyer's country and India, occurrence of civil war, rebellion, revolution, insurrection or other disturbances in the buyer's country, new import restrictions, cancellation of valid import license etc. The policies issued covered maximum of 100 *per cent* of exports value for political risks and 80 to 95 *per cent* for commercial risks.

### 3.2 Performance of short term policies issued to exporters

The Company issued 13 types of short term policies to exporters (**Annexure I**), broadly classified as declaration or exposure based. While, under declaration policies, the exporters were required to intimate on a monthly/quarterly basis all the shipments sent during the previous month/quarter; in exposure based policies, the shipment declaration clause was waived, but the exporters were expected not to send shipments to those buyers who were listed as 'defaulters' by the Company.

The overall performance of policies issued during five years ending 2010-11 is indicated in the table below:

(₹ in crore)

Year	Value of business cover	Gross Premium	Claims Paid	Recoveries effected	Net Claims (Claim paid less recoveries)	Surplus (Gross premium less Net claims)
2006-07	50421	190.91	120.10	4.34	115.76	75.15
2007-08	52767	205.32	133.88	8.29	125.59	79.73
2008-09	68866	246.59	216.01	8.92	207.09	39.50
2009-10	85643	288.09	269.98	15.06	254.92	33.17
2010-11	92884	332.51	160.47	8.82	151.65	180.86

A review of the above table indicated that gross premium increased by 74 per cent in 2010-11 when compared to 2006-07, aligning with the growth in the business covered. In 2008-09 and 2009-10, there was substantial increase in the claims paid, resulting in reduction in surplus to the extent of nearly 50 per cent when compared to surplus generated in 2006-07. In the year 2010-11, there was increase in premium as well as sharp decline in the claims which resulted in substantial surplus.

### 3.3 System of fixing limit on buyers

Under declaration policies, exporter was required to obtain credit limit (CL) on the buyer upto which the Company was liable to compensate in case of a loss on account of commercial risks. Therefore, the exporters approached the Company with the details of the buyer and sought CL by submitting an application along with remittance of processing fee. On receipt of Credit Limit Application (CLA), the Company assessed the capacity and willingness of the buyer to meet their financial obligations at a future date by considering various financial and non-financial factors. Based on such assessment, the Company fixed a limit termed as 'Overall Limit (OL)' up to which the Company was willing to take exposure on a buyer. This OL fixed on the buyer, was then available for allocation as Credit Limit (CL) to individual exporters. CL was thus, the limit upto which the Company considered claim to each exporter in the event of loss arising on account of commercial risks.

In this connection, audit observed the following deficiencies:

In the earlier Performance Audit Report of 2009-10, avoidable claim payments of ₹ 16.13 crore under Shipment Comprehensive Risks (SCR) policies, due to approval/enhancement/non-cancellation of OL on importers, despite adverse remarks of credit information agencies was reported. Audit had recommended that the Company should

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 were to be taken into account in proposing an OL for a particular buyer. This was supposed to facilitate Buyer Underwriting Department (BUD) to submit an objective assessment of the buyer to the Management for taking a transparent and appropriate decision while approving/enhancing the OL. In the ATN (January 2011), the Ministry replied that the Company had implemented the audit recommendation. However, it was seen that 'Objective Review Note' introduced for CLs was not based on a system of pre-determined weights. Therefore, the Company was yet to comply with the accepted audit recommendation made in the earlier Performance Audit Report.

During the present audit, 155 claims paid (₹ 301.18 crore) were checked, which involved 98 buyers and deficiencies in respect of fixation of OL in respect of 48 buyers were observed as detailed below:

- In respect of 31 buyers (**Annexure II**) the Company fixed OL despite insufficient information from Credit Information Agencies (CIAs) or absence of latest financial data. There was a claim outgo of ₹ 141.27 crore in these cases. The cases of four buyers, with OL above ₹ 20 crore indicated the following:

(₹ in crore)

Sl. No	Buyer Name/ country	Date of CIA report	Financial Information status	Date of sanctioning of OL	OL sanctioned	Claims paid	Claims paid in the year
1	Trade AM, USA	14.07.2005	1998, 1999, 2000	27.07.2006	65.00	58.33	2008-09
2	Beekay, Hongkong	17.10.2006	No financial information	19.10.2006	26.50	23.23	2008-09
3	Andin International, USA	11.11.2006	No financial information	25.06.2007	23.00	14.13	2009-10 2010-11
4	4004 Incorporated, USA	06.03.2008	No financial information	31.03.2008	65.00	17.62	2008-09
<b>Total</b>						<b>113.31</b>	

It could be seen from the above table that the Company had sanctioned OL in July 2006 to Trade AM, USA although the CIA report of July 2005 contained financial information as old as that of the year 2000. Further, in case of all the other three buyers, although no financial information was available, the Company sanctioned OL. The claim settled on account of these four buyers itself amounted to ₹ 113.31 crore. In addition, the Company paid claims for ₹ 27.96 crore in respect of other

27 buyers for whom also the Company fixed OL based on insufficient financial information.

- In 17 other cases, the Company continued to sanction OL despite adverse remarks / recommendations in the CIA report such as, no credit recommended, turnover decrease and increase in loss, undetermined credit appraisal, loss making, claims could be in dispute, postpone exposure, negative net worth, litigation cases, financial condition unbalanced etc. (**Annexure III**). The claim settled in respect of these cases amounted to ₹ 17.13 crore.

Hence, the deficiency in the fixation of OL contributed to enhanced credit risk and higher incidence of claim to the extent of ₹ 158.40 crore (₹ 141.27 crore plus ₹ 17.13 crore).

*The Company replied (March 2012) that financial information readily available with the agency was taken into consideration and policy holders experience was considered as the basis for fixation of OL. Further, it was stated that the buyers continued to be a good risk based on the past payment record, despite some adverse features in the report.*

*The Ministry in its reply (June 2012) further added that in many countries, Companies were not obliged to publish financial statements and also buyers were reluctant to disclose financial statements to the credit information agencies. Thus, fixation / enhancement of OLs were based on the Company's experience. It was stated that the Company was in the process of developing the system for rating of Buyers and fixation / enhancement of OLs based on pre-determined weights and the system was expected to be in place by September 2012.*

The reply of the Company/Ministry was to be viewed in the light of the fact that credit limits on buyer needed to be based on the adequate financial information on the buyer and any laxity in this critical area was likely to impact the Company adversely with increased claims.

### **3.4 Underwriting deficiency in issue of customized policy to MSTC Limited**

MSTC Limited (MSTC), a GOI enterprise acted as a canalizing agency for exports for gold ornaments. The Company issued a customized Export Turnover Policy covering the period from 29 August 2007 to 31 August 2008. The expected turnover was around ₹ 1000 crore and the minimum premium was fixed at ₹ 1.50 crore with a maximum liability of ₹ 300 crore. During the course of policy, MSTC applied to the Company for enhancement of maximum limit from ₹ 300 crore to ₹ 600 crore and the same was agreed

(April 2008). The policy was renewed for the period from 1 September 2008 to 31 August 2009 with an expected turnover of ₹ 1200 crore and a minimum premium of ₹ 2.40 crore. The coverage of loss was fixed at 90 *per cent* and upto CLs approved on individual buyers.

MSTC filed 37 claims (March 2009 to November 2009) for a total value of ₹ 452.81 crore due to buyers default in respect of shipments made by its three associates viz. Ushma Jewellery and Packing Exports Pvt. Ltd., Mumbai, Space Mercantile Company Pvt. Ltd. Mumbai and Bonito Impex Pvt. Ltd. Mumbai. The Company rejected the claims (May 2010) citing reasons such as policy issued did not cover the failure of suppliers in India, failure of MSTC to adhere to policy conditions etc. MSTC had filed (October 2010) a case with National Consumer Disputes Redressal Commission, New Delhi, against the repudiation of the claims.

In this regard, following system deficiencies were observed -

- At the time of issuing the policy (29 August 2007), the Company did not ensure that MSTC had any insurable interest by establishing the relationship between MSTC and its associates though it was aware (July 2007) that procurement and shipment of goods would be done by the associates and MSTC would merely act as a canalizing agency. In fact, MSTC had already entered (16 August 2007) into a Memorandum of Agreement (MOA) with its associates i.e. prior to issuance of the policy by the Company.
- The Company did not cancel the customer specific policy issued to MSTC even after being aware (November 2008) that MSTC did not have insurable interest in view of MOA and amendment to MOA (August 2007) which contained that ‘associates’ were responsible for quality, quantity, price and documentation of shipments and also responsible for the payments due from the buyer.

In view of the above lapse in underwriting, the Company was saddled with claims of ₹ 452.81 crore and subsequent litigation on account of rejection of these claims. The above claims included an amount of ₹ 5.57 crore in respect of six shipments which were effected during November 2008 and December 2008 i.e. after the Company became aware of MOA.

*The Company replied (March 2012) that it had received copy of MOA in November 2008 and that it would not have issued a policy had MSTC disclosed the existence of MOA earlier. By November 2008, MSTC had begun filing ROD on their overseas buyers.*

*Hence, even if ECGC had cancelled the policy in November 2008, it would not have materially altered its liability, if any, under the policy.*

*While endorsing Company's reply regarding MOA, the Ministry further added (June 2012) that MSTC had declared itself as an exporter in the proposal form and sought cover of non-payment on a specified list of buyers. Accordingly, the policy was issued after assessing the risk on the overseas buyer. It further stated that at the time of claim, the Company found that the exporter had failed to disclose material information (regarding existence of MOA), which affected the Company's liability and therefore the claim was rightfully rejected.*

The reply of the Company and Ministry was not acceptable as the Company did not exercise due diligence of obtaining full particulars relating to relationship between MSTC and associates prior to issuance of policy in August 2007 even though it was aware about the transaction modalities. Further, even after getting to know that MSTC had entered into an MOA with the associates, the Company did not cancel the policy forthwith resulting in additional claims of ₹ 5.57 crore.

### 3.5 Settlement of claims to exporters

A credit insurance policy issued to the exporters read with proposal form was a legal agreement between an insured and an insurer. The policy issued contained clauses detailing the obligations of the insured, which were to be diligently observed and the non-observance entitled the insurer to reject claims. One of the vital clauses of the policy relating to acceptance of liability by the Company was that due performance and observance of each term and condition contained therein or in the proposal or declaration was a condition precedent to any liability of the Company there-under and to the enforcement thereof by the insured.

However, the Company issued an internal circular (September 2007) by which it treated acts of omission and commission amounting to breach of a basic condition of the policy like payment of premium in respect of shipments under claim after the due date of the payment by the buyer or after the occurrence of default / insolvency / repudiation of contract, non-declaration and non-payment of premium on shipments under claim, absence of valid credit limit on the date of shipment, failure to prefer claim within the time limit prescribed etc. as Category 'A' lapse and allowed competent authorities of the Company to condone these as lapses by reducing the claim payable amount by minimum 10 per cent. Further, lapses such as delay in remittance of premium before the payment became overdue, omission to declare shipments preceding earliest shipment under the claim etc were classified as Category 'B' and allowed competent authority to condone

these lapses by reducing the claim amount by 0 to 50 *per cent*. It also listed certain other lapses as Category ‘C’ lapse which could be condoned by the competent authority without reducing the claim amount. Deviations other than those categorised under the above categories were not to be treated as a lapse.

During the three years 2008-09 to 2010-11, the Company settled 2163 claims amounting to ₹ 646.46 crore out of which, audit scrutinized 155 claims amounting to ₹ 301.18 crore (47 *per cent*). We observed that in 88 out of 155 claims, the Company paid ₹ 145.19 crore by condoning the lapses/deviations as per details given below:

Type of Lapse condoned	No. of claims condoned	Claim paid (₹ in crore)	Amount deducted (₹ in crore)
A category	30	36.08	10.37
B category	28	43.26	2.55
C category/ Minor deviations	30	65.85	0.00
<b>Total</b>	<b>88</b>	<b>145.19</b>	<b>12.92</b>

The condonation of various breaches at the time of claim was against the spirit of the policy conditions. Further, condonation of category ‘A’ lapses which involved grave violations such as non availability of sufficient balance in deposit premium account, non declaration of shipment till it became overdue for payment, time barred claims, claims where no valid credit limit were available as on the date of shipment etc. was not in order and resulted in avoidable payment of ₹ 36.08 crore.

*The Company replied (March 2012) that condoning of any lapse was not done as a matter of routine. It was further stated that it was playing a developmental role and its objective was to promote exports and mitigate the risks faced by the Indian exporters, in that process the Corporation was required to be pragmatic and practical while admitting claims.*

*The Ministry, while endorsing the reply of the Company, further added (June 2012) that certain conditions in the policy were mentioned more as enabling provisions or more as deterrents for compliance with certain procedures for orderly administration of the schemes rather than as a condition precedent for settlement of claims. It also stated that condonation of lapses were more related to procedure to be followed and not related to any policy matter.*

The replies needed to be viewed in light of the fact that 57 *per cent* of the test checked cases involved condonation of lapses and hence it was not done on exceptional basis.

Further, as the Policy was a legal document and all clauses had to be complied mandatorily, the argument that the clauses in the policies were merely deterrents for compliance was not correct. The adherence to policy conditions like timely submission of shipment information, filing of overdue reports, payment of premium etc. form the basis of the insurance cover and were not merely procedural formalities.

### 3.6 Inadequate recovery efforts

One of the basic principles of insurance is 'subrogation'. Under subrogation, after settlement of claim, the insurance Company steps into the shoes of insured and obtain the rights of recovery. We observed that the Company was not following the principle of subrogation and was entirely dependent on the exporter to effect recovery from the buyer.

The amount to be recovered increased from ₹ 946.27 crore in 2008-09 to ₹ 1341.76 crore in 2010-11. The year-wise claims paid and recovery effected by the Company was as under:

FY	Claim paid	Amount recovered	Percentage of recovery
	₹ in crore		
2008-09	216.01	8.92	4.13
2009-10	269.98	15.06	5.58
2010-11	160.47	8.82	5.49

The recovery rate of the Company ranged from 4.13 *per cent* to 5.58 *per cent* only during 2008 to 2011.

*The Company in reply (March 2012) stated that in order to improve its recoveries, it had introduced the procedure of insisting on the exporter to enter into an agreement with the Debt Collection Agencies (DCAs) for recovering the dues from the buyer before preferring claims. It further stated that the DCAs also directly kept the Company informed of the developments. In addition to the above steps, the Company stated that it was also examining other options, to improve recoveries from the buyers.*

*The Ministry, while endorsing the reply of the Company, stated (June 2012) that the Company would examine the aspect of subrogation rights taking into consideration provisions of FEMA<sup>27</sup> and other legal issues.*

<sup>27</sup> *Foreign Exchange Management Act*



### 3.7 Introduction of new products – Small and Medium Enterprise Policy

Report of Working Group on rehabilitation of sick SMEs (April 2008) released by RBI estimated that small sector industries units exported ₹ 124417 crore and ₹ 150242 crore in 2004-05 and 2005-06 respectively. As per this report, Micro, Small and Medium Enterprises (MSME) sector of the Indian economy was contributing over 39 *per cent* of the manufacturing sector output and 33 *per cent* of the national exports. In order to promote and to accord high priority to MSME sector, the Company introduced (April 2008) a new exposure based policy for MSME with an intention to simplify the procedural formalities. The maximum liability under the policy was capped at ₹ 10 lakh and the single loss limit under the policy was ₹ 3 lakh.

In this connection, the following points were observed:

- The salient feature of the product was to target exporters who were classified as micro exporter as per MSME Development Act 2006. However, only three policies were issued during the three years 2008-09 to 2010-11.
- The policy roll out was neither preceded by any customer survey/projections nor any feedback was taken from the market though the underwriting policy emphasized the need for designing the product based on the customer feedback.
- There was also no review of the performance of the policy for making midway corrections to popularize the same.

Thus, the policy failed apparently and the Company thus lost the opportunity for tapping huge business potential of the sector.

*The Company agreed (March 2012) that the policy was unsuccessful as small exporters already held either SCR or Small Exporters Cover policies. Further, it stated that exporters were not enthused by this policy owing to limitation of maximum liability and single loss limit to ₹ 10 lakh and ₹ 3 lakh respectively. The upper limits were purposely kept low as annual turnover of the targeted exporters was not expected to cross ₹ 50 lakh. Limits were not raised consciously as the policy holders under this product were to get automatic limit on a buyer (not appearing in the negative list of the Company) even without any financial verification. Such discretion could not be given for high value credit limits.*

*The Ministry endorsed (June 2012) the reply of the Company regarding small exporters being covered by various other products and a separate product for SMEs may not be required. However, it stated that the Company would, after getting market feedback, make necessary modification in the product, if it was considered worthwhile to continue the product.*

### 3.8 Non-sustainable product – Small Exporter’s Cover

Small Exporter’s Cover (SEC) was meant for small exporters whose anticipated export turnover for a period of one year did not exceed ₹ 50 lakh. The loss on account of commercial risks and political risks to the extent of 95 per cent and 100 per cent respectively was covered. The period under the policy was 12 months. The minimum premium adjustable was ₹ 2,000.

The premium income, claims paid and recoveries under the policy made during the five year period from 2006-07 to 2010-11 were as under:

(₹ in lakh)

	2006-07	2007-08	2008-09	2009-10	2010-11
Premium (1)	62.88	51.55	58.68	42.67	29.58
Claims paid (2)	385.93	310.88	201.41	83.34	49.35
Recoveries (3)	2.82	2.82	8.43	33.93	0.00
Net (1-2+3)	-320.23	-256.51	-134.30	-6.74	-19.77

The product was unviable in all the five years from 2006-07 onwards but still the Company continued to issue policy to exporters without appropriate safeguards to the financial interest of the Company.

*The Company replied (March 2012) that the availability of the policy in this simplified form was more important than generating surpluses from the scheme.*

*The Ministry, however, stated (June 2012) that the Company would review the product features.*