Executive Summary

Export Credit Guarantee Corporation of India Limited, a Company fully owned by the Government of India was formed in 1957 with the objective of catalyzing the promotion of exports from the country by covering the risks of exports on credit. It is registered with Insurance Regulatory and Development Authority (IRDA) as a general insurance company dealing in credit insurance policies/covers.

Our main audit objective in conducting this Performance Audit was to examine the operational performance of the Company during the years 2008-09 to 2010-11 with a view to assessing the effectiveness of system in place for underwriting risks and settlement of claims relating to covers issued to banks and short term policies issued to exporters. During the course of audit, adequacy of the risk mitigation measures in place for protection against large claims was also examined. Significant audit findings are narrated below:

Shortcomings in underwriting of covers issued to Banks

The Company offered whole turnover covers to the Banks to protect them against the default by the exporter who had availed Packing Credit or Post Shipment Credit. During 2008-09 to 2010-11, the Company issued 108 Whole Turnover Packing Credit (WTPC) covers to 36 Banks and 92 Whole Turnover Post Shipment (WTPS) covers to 31 Banks. A review of 102 covers issued to 34 Banks under WTPC and 86 covers issued to 29 Banks under WTPS showed that there was a profit of ₹ 665.78 crore under WTPC and a loss of ₹ 191.72 crore under WTPS during the above period.

(Para 2.2)

Out of 29 Banks to whom WTPS cover was issued, the Claim Premium Ratio (CPR) of 13 Banks was more than 200 *per cent* and resulted in a loss of ₹ 309.27 crore during 2008-09 to 2010-11. The Company did not have an effective system of incentives and disincentives under WTPS for containing the adverse claim ratio.

(Para 2.2.1)

The consortium agreements amongst the Banks to finance the exporters posed an enhanced credit risk and the Company had no mechanism to know of this arrangement except only at the time of their filing the Report of Default. Out of 29 claims examined in audit, 26 claims involved nine Banks under consortium arrangement and related to only one commodity viz. diamond. The Banks had extended 477 advances to four exporters for a value of ₹ 518.87 crore relating to diamond exports, which ultimately culminated in a claim of ₹ 278.43 crore. Detailed examination of 310 advances for ₹ 322.67 crore out of the above 477 advances showed that 240 advances were extended to exporters involving Hongkong based buyers accounting for claims of ₹ 170.10 crore. Same individuals were either owners or Chief Executive Officers representing more than one buyer. The Banks extended 83 advances for ₹ 133.90 crore covering exports to nine buyers, who were represented by three individuals, with a claim payout of ₹ 67.21 crore. The consortium member Banks extended advances to four exporters for ₹ 12.83 crore, covering the exports to buyers who had already defaulted.

(Para 2.2.2)

The Company paid claims of ₹ 316.13 crore despite buyer verification reports obtained by the Banks being either outdated or unsatisfactory or post dated.

(Para 2.2.3)

While underwriting individual risks of exporters, the Company only relied on information furnished by the Banks without any access to the Banks' appraisal system. In the absence of an independent appraisal system, even in case of large risks like Zoom Developers Limited, the Company injudiciously continued its counter guarantee without ensuring the completion of the projects. These guarantees were extended for more than five years even though the normal validity of these guarantees was six months. Invocation of guarantees by the buyers on account of non-completion of projects resulted in claims and the net claim liability likely to devolve on the Company worked out to ₹ 1047 crore.

(Para 2.2.4)

Banks sanctioned Post Shipment advances by discounting the bills drawn on the buyers who were already figuring in the defaulters list of the Company. This resulted in claim payment of ₹ 23.40 crore. Four other buyers who had defaulted in repayment of advances during January 2009 to February 2010 and where the Company had paid ₹ 20.73 crore as claims were not placed in defaulters' list.

(Para 2.2.7)

After settlement of claims, branches of the Company were required to pursue the recoveries with the Banks and branch-wise targets were also set in this regard. We observed that pending recoveries had gone up from ₹ 2170 crore in 2008-09 to ₹ 2628 crore in 2010-11. The actual recoveries made during these years also declined from ₹ 151.29 crore in 2008-09 to ₹ 110.65 in 2010-11 which was indicative of inadequate recovery efforts.

(Para 2.2.10)

Deficiencies in short term policies issued to exporters

The system of appraisal of buyers and fixation of Overall Limit (OL) based on financial and non-financial parameters was flawed. In 48 out of 98 buyers selected in audit, the Company had fixed/enhanced the OL without obtaining latest and full financial information about the buyers or despite unfavorable reports of Credit Information Agencies, involving payment of claims to the extent of ₹ 158.40 crore.

(Para 3.3)

The Company issued a customized policy in August 2007 in favour of MSTC Limited (MSTC) covering the risk of default of payment by the domestic suppliers which was renewed in August 2008. However, it 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. 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. 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 between MSTC and its associates.

(Para 3.4)

It was seen that the exporters were not complying with the terms and conditions of the policy and yet the Company settled claims filed by them. During the three years ending 31 March 2011, we observed that in 88 out of 155 claims, the Company paid ₹ 145.19 crore by condoning the lapses/deviations and after deducting a nominal amount. Out of the above, in 30 cases amounting to ₹ 36.08 crore, the breaches committed involved serious omissions.

(Para 3.5)

The amount to be recovered from the buyers against the claims paid to the exporters increased from ₹ 946.27 crore in 2008-09 to ₹ 1341.76 crore in 2010-11. The recovery rate of the Company ranged from 4.13 *per cent* to 5.58 *per cent* only during 2008-09 to 2010-11.

(Para 3.6)

Risk assumption without adequate reinsurance

The Company's medium and long term exposures i.e. project exports were not covered by adequate reinsurance arrangement though the maximum liability ranged between ₹ 2100 crore to ₹ 5984 crore during the three years ending 31 March 2011.

(Para 4.3.1)

The Company did not take Excess of Loss protection in 2010-11. There were large claims in respect of two exporters during the year for ₹ 157.27 crore. In the absence of above protection, the entire amount had to be borne by the Company. The Excess of Loss protection could have resulted in a recovery of ₹ 101.55 crore.

(Para 4.3.2)

Recommendations

Based on the Audit findings, the following recommendations are made:

- **The Company needs to introduce an effective system of incentivising the Banks with lesser claim ratio and disincentivise Banks with higher claim ratio in WTPS. The Company should also consider laying down normative Claim Premium Ratio in order to benchmark the incentives/disincentives.**

- **The Company may put in place a system to obtain information regarding consortium agreements among the Banks to assess the concentration at the time of underwriting to protect its financial interests.**

- **Audit reiterates the earlier recommendation that in order to reduce the risk of claims, the Company needs to make it mandatory for Banks to carry out credit worthiness verification of foreign importers before sanctioning advances. The Company should insist on obtaining from the Banks, a certificate that due diligence has been carried out on the credit worthiness of the buyers.**

- **The Company should put in place an effective system for assessment of buyers while fixing OL by assigning appropriate weights for both financial and non-financial parameters.**

- **Settlement of claims condoning grave lapses on the part of exporters should be resorted only on an exceptional basis.**

- **The Company needs to strengthen the system of recovery from buyers so as to match with the peers in other countries.**

- **The Company needs to have an appropriate reinsurance protection commensurate with its exposures, to safeguard against uncertainty and instability of global markets.**