

Chapter IV

Trade and Investment

Insurance System of the Philippines

TRADE AND INVESTMENT INSURANCE SYSTEM IN THE PHILIPPINES

I. BRIEF HISTORY OF EXPORT CREDIT INSURANCE

A. Background

The establishment of an export credit insurance facility in the Philippines had been considered as early as the seventies. A first step taken was the creation by law in 1972 of the Philippine Export Credit Insurance and Guarantee Corporation (PECIGCOR). However, the corporation never took off and was eventually abolished in 1979 by virtue of Executive Order No. 574 which transferred the corporation's functions to PHILGUARANTEE. In 1981, the Export Credit Corporation (ECC) was also established to perform, among others, an export credit insurance function. The corporation which never became operational, was likewise abolished in 1997 and its functions are also transferred to PHILGUARANTEE by virtue of Executive Order No. 127.

In the mid-eighties, the establishment of an ECI was again reviewed. The proposal to establish an ECI facility was deferred as studies have shown that the perceived need of export then was more on pre-shipment financing and guarantee rather than credit insurance.

In 1995, a decision was made to design a comprehensive ECI system suited to the needs of Philippine exporters including an interim system as may be required and to operationalize the system by establishing the appropriate facility in PHILGUARANTEE.

B. Developments

ECI PROJECT STUDY

Technical assistance under the World Bank - Japan Grant Export Development Project was utilized to fund two (2) constancy studies:

1. Establishment of an Export Credit Insurance facility in PHILGUARANTEE; and
2. Establishment of a Comprehensive Credit Information System (CCIS) to back up the ECI Program.

The ECI Project Study assessed the need for an ECI through a market survey of both exporters and bankers. It also contained an evaluation of Philippine export performance profile of exports, market patterns etc. Likewise, a review of existing policies, laws and regulations was made. The consultant's report showed there is a need for an ECI Program and the establishment of the ECI Program on an interim basis was recommended. A comprehensive Program will follow after a review is conducted.

The ECI Program was launched on January 31, 1997 and PHILGUARANTEE became the first and the only institution to offer an ECI facility in the Philippines.

The CCIS study, on the other hand, dealt with comprehensive credit information system, including a foreign buyers database, to provide support to ECI underwriting operations.

II. INSTITUTIONAL FRAMEWORK AND ORGANIZATIONAL SET-UP

A. *Legal Authority for the Establishment of the Export Credit Insurance (ECI) Program at PHILGUARANTEE*

As mentioned earlier, PHILGUARANTEE's authority to perform ECI functions derives from its absorption of the mandates of the two (2) defunct agencies, the Export Credit Corporation (ECC) and the Philippine Export Credit Insurance and Guarantee Corporation (PECIGCOR).

The accumulated legislation describing the powers and functions of PHILGUARANTEE are contained in the following decrees, executive orders and Acts of the Republic.

1. Presidential Decree No. 1080 creating PHILGUARANTEE in 1977.
2. Republic Act No. 6424 of 1972 creating the Philippine Export Credit Insurance and Guarantee Corporation (PECIGCOR) whose functions were transferred to PHILGUARANTEE in 1979 by Executive Order No. 574.
3. Presidential Decree No. 1785 of 1981 creating the Export Credit Corporation (ECC) whose functions were transferred to PHILGUARANTEE in 1987 by the Executive Order No. 127.

On August 29, 1996 the Office of the Government Corporate Counsel (OGCC) issued its Opinion No. 241 which stated that PHILGUARANTEE can offer export credit insurance to any bank or business in the Philippines on the basis of the combined provisions of Republic Act No. 6424 and Presidential Decree No. 1785. By virtue of this opinion, the authority of PHILGUARANTEE to act as an export credit insurance agency is confirmed.

B. Organizational Set-Up

1. **Board of Directors** - The power and functions of the Corporation are exercised by a Board of Directors composed of seven (7) members, as follows:
 - a. The Secretary of Finance, who shall be the Chairman of the Board. Whenever the Secretary of Finance is unable to attend, he shall designate an undersecretary to attend as his alternate who shall not act as Chairman.
 - b. The President of the Corporation, who shall be the Vice-Chairman of the Board, shall assist the Chairman and act in his stead in case of absence or incapacity.
 - c. The Secretary of Trade and Industry.
 - d. The Governor of the Bangko Sentral ng Pilipinas (Central Bank of the Philippine).
 - e. The Director-General of the National Economic and Development Authority.
 - f. The Chairman of the Development Bank of the Philippines.
 - g. The Chairman of the Philippine Overseas Construction Board.

2. Functional Areas:

Philguarantee is composed of nine (9) departments directly supervised by three (3) Senior Vice Presidents, as follows:

- Senior Vice President for Operations Group
 - a. Marketing and Business Development Department
 - b. Guarantees Department
 - c. Export Credit Services Department
 - d. Remedial Management Department
- Senior Vice President for CTA Group
 - e. Controllership Department
 - f. Treasury Department
 - g. Administrative Department
- Senior Vice President for Legal Services Group
 - h. Collection and Litigation Department
 - i. Documentation and Research Department

The Corporate Planning Office and Corporate Secretary's Office are functionally attached to the Office of the President while the ECI Office is attached to the Office of the Executive Vice President.

Since its launching in January 1997, the ECI Program has been operationalized on an interim basis using existing staff as follows:

- **Underwriting function** - handled by the Export Credit Insurance Office (ECIO). It is responsible for evaluating export proposal applications for the establishment of foreign buyer credit limits, issuing offer letter, determining the premium rate to be applied and ensuring the existence of an acceptable spread of risks. It is also responsible for premium billing, issuance of the Policy and maintenance of policy holder files.

- **Marketing function** - handled by the Marketing and Business Development Department (MBDD) which is responsible for recruiting prospective policy holders. It handles all inquiries and assists in filling out the application/proposal forms correctly, and sees to it that the processing fee is billed and receipted properly.
- **Credit Information, Management Information System, Economic intelligence and Country Risk Analysis function** - handled by the Export Credit Services Department (ECSD). These include evaluation of industry and country risks, making recommendations on country classifications, imposition or removal of special country limitation conditions, providing guidance on special industry conditions and trends of potential concern to management.

ECSD is also responsible for interfering with international sources of credit information on foreign buyers through COFACE. It likewise maintains a database on Philippine direct and indirect exporters.

- **Claims Handling and Recoveries function** - handled by the Remedial Management Department (RMD) with the support of Legal Services Group. It receives the Notices of Overdue Account and Notices of Claim and exporters request for intervention as well as evaluates the validity of claims and undertakes recovery measures. In case of payment, it also requests COFACE for reimbursement or funding as the case may be.
- **Accounting function** - handled by the Controllershship Department. It is in charge of remitting fees to COFACE, keeping accounting records and preparing ECI Program financial statements.
- **Treasury function** - handled by the Treasury Department which is responsible for insuring availability of funds for the open Requirements of the Project. It is also in charge of the issuance of official receipts on all collections from ECI operations, providing information/data on foreign exchange rates, processing request for payments of foreign remittances and the maintenance of a separate account designated as Premium Reserve fund in accordance with the terms of the Reinsurance Agreement with COFACE.

The interim organization treats the ECI program as another product along with PHILGUARANTEE's other existing program. This set up is considered most convenient and economical for PHILGUARANTEE since ECT operations are just in the start-up stage. In anticipation of the increase in volume of ECI business, the PHILGUARANTEE Board approved on June 20, 1997 the creation/expansion of the following units to strengthen organizational support for ECI.

1. Expansion of ECIO into a Department with two (2) Underwriting Divisions
2. Creation of Country Risk Assessment Division under ECSD
3. Creation of Visayas-Mindanao Division under MBDD

The Manager of ECI Department will report to the Senior Vice President for Operations.

III. TYPES, FEATURES, TERMS AND CONDITIONS OF INSURANCE

A. Types of Insurance Policies:

- a. **Comprehensive Short-Term Shipments Policy** - covers both political and commercial risks of non-payment of export credits with a term of up to 180 days from shipment date.
- b. **Commercial Risk Only Short-Term Shipments Policy** - where exporter's buyers are all in OECD countries or developed market/economies, a policy may be issued where only commercial risk will be covered.

B. Program Features

- a. Eligible for cover

Any exporter doing business in the Philippines provided that the exported goods and services contain at least 20% local (Philippine) content based on FOB value.

b. Insurable exports include:

1. Philippine exports denominated in an acceptable foreign convertible currency payable in the Philippines
2. Export sales on either documentary or open account term and involving firm contracts for payment up to 180 days from export shipment date.

c. Coverage

1. Maximum of 85% of the amount of loss
2. Global basis, meaning it covers all contracts with buyers covered under the Policy to ensure an acceptable spread of risks. Export sales on cash and irrevocable L/C may however be excluded.

d. Validity Period

The policy shall be valid for one (1) year from date of issue.

C. **Terms and Conditions**

1. Risks to be covered

a. *Political risks include*

- i. currency inconvertibility or transfer payment risk
- ii. foreign government acts which prevent the importation of the goods;
- iii. cancellation of previously issued import licences; and
- iv. war (including civil war), riot, rebellion, revolution, insurrection or other similar disturbances in the buyer's country

b. Commercial risks include:

- i. insolvency of the buyer;

- ii. protracted default or delay in payment i.e. failure of the buyer to pay the exporter the gross invoice value of goods delivered to and accepted by the buyer.

2. Exclusions

- a fluctuations in exchange rates
- b where other insurance coverage applies such as fire and marine insurance
- c insolvency or default of an agent of the exporter or of any bank
- d contract of sale to insured's affiliate
- e non-payment due to sales contract disputes between the exporter and overseas buyer or where either the exporter or buyer commits a breach of any term of the contract covered by the policy
- f cases where the insured exporter authorizes payment in a currency other than the currency stipulated in the contract
- g cases where the insured exporter has entered into a compromise agreement without PHILGUARANTEE's written consent
- h natural catastrophic risks and the nuclear risk
- i war between any of the world's major powers and between the country of the insured and of the buyer.

3. Limitation of Liability

- a. **A Buyer Credit Limit (BCL)** is the maximum amount of credit that can be extended to a particular buyer at a given time based on credit information obtained on that buyer and on underwriting guidelines. However, the BCL shall not exceed a Single Buyer Credit Limit (SBCL). The SBCL shall be set at one percent (1%) of the ECT Program Capital on a leveraged basis. Single buyer shall also mean buyers controlled by the same ownership group. In case there is reinsurance, the SBCL shall be adjusted accordingly depending on the percentage of retention.

- b. **Maximum Liability** is the maximum amount that PHILGUARANTEE shall pay, in the event of loss, to the exporter for all buyers under the Policy. This shall be a certain multiple of the premium paid.

D. **Premium Structure**

A premium shall be computed based on the gross invoice value of goods shipped. The applicable premium rate will depend on the country classification schedule grading credit terms, and underwriting guidelines.

A minimum non-refundable premium shall be paid in advance, computed on the basis of the exporter's estimated export sales at the time of application. Subsequently, the actual premium shall be computed based on submitted monthly exports of actual shipments. If the actual premium is higher than the minimum premium, the difference shall be paid to PHILGUARANTEE at the end of the quarter.

There is also a processing fee to be paid by the exporter. The cost of obtaining credit information on the foreign buyer is likewise passed on to the exporter.

IV. **PRODUCT DEVELOPMENT, PROMOTION AND MARKETING**

A. **Product Development**

- June 30, 1995 World Bank approved the grant from Japan Export Development Project for the Export Credit Insurance (ECT) and Comprehensive Credit Information SYSWM (CCIS) projects
- August 1995 and Training on ECI fundamental (USA)
March 1996 and trade and investment insurance (Japan) for PHILGUARANTEE officers
- January - April 1996 ECI Market survey
- July 1996 Consultancy work m ECI and CCIS started
- August 1996 ECI supplemental survey (large/traditional exporters and foreign banks)
- September 1996 Consultancy Report on ECI submitted

- November 1996 Training on ECI by ECICS Singapore
- December 1996 Consultancy Report on CCIS submitted Training in COFACE, France
- December 27, 1996 PHILGUARANTEE Board's approval of implementation of ECI
- January 31, 1997 Launching of ECT and Signing of Partnership including Reinsurance Agreements between PHILGUARANTEE and COFACE

Upon securing the funding for the ECT and CCIS projects, an ECI Project Committee was created which acted as the local counterpart of the foreign consultants hired to conduct the studies.

All tasks undertaken on the ECI is being coordinated by the Committee from its planning up to its launching and implementation. Its task is still continuing since the ECI program is still in its interim stage until PHILGUARANTEE is able to deliver a comprehensive ECI facility.

Its on-going tasks include:

1. Coordination with COFACE, France on matters regarding Partnership, Reinsurance Agreements
2. Monitoring of the interim ECT facility particularly on how the existing structure/organisation is able to respond/deliver services to exporters
3. Formulation of staff development plan, including identification of training needs/courses on ECI management and operations
4. Design and development of a computerized system to manage the limited facility, including software and hardware requirements with provision for expansion to handle a larger ECI facility
 - a. Management Information System Local Area
 - b. Networking of the Operations Group to integrating all database to be used for all PHILGUARANTEE products
 - c. Database for CCI S - exporters data and foreign buyers' access
5. Formulation of an interim business plan
 - a. determine and set-up of reserve fund/capitalization
 - b. financial budget requirements to operate the limited facility
6. Formulation of a marketing and promotions plan

7. Monitoring of ECI operations to assess/determine probable default rate and risk percentages
8. Review of the insurance policy itself

B. **Promotion and Marketing**

• **Objectives**

- a. To increase awareness among exporters on the features and benefits of the ECI
- b. To solicit clients/policy holders for ECI
- c. To enlist the support and acceptance of the ECI from existing and new PHILGUARANTEE exporter-clients
- d. To establish PHILGUARANTEE as the first and only institution to implement an ECI facility in the country
- e. To ensure the viability of ECI operations in PHILGUARANTEE.

Marketing activities are aimed at informing end users on the features and benefits of the ECI. The long term marketing goal is to establish ECI as an effective facility for exporters. At the macro level, ECI is projected as a means to attain increased productivity in the export sector and to secure them in the global market. We therefore emphasize the gains experienced by other countries where ECI facility was implemented and at the same time create an image awareness in the business community that PHILGUARANTEE is the national export credit agency (ECA) which provides a complete package of financial services to the exporters.

• **Marketing Activities/Strategies**

a. **Launching**

In order to meet the above objectives, the MBDD has drawn up its marketing plan and the ECI Program was launched as being the first of its kind in the country as a well-

publicized event Press from local newspaper, radio and television covered the launching which was held on January 31, 1997 to coincide with the 20th Anniversary celebration of PHILGUARANTEE.

b. Seminars/Conferences/Briefings

This is aimed to sustain the awareness generated by the launching of the program, such activities must be timed so as not to coincide with any major trade/export activity to achieve maximum coverage and participation.

ECI seminars/conferences in various regions of the country where most exporters in the countryside are located were arranged by Marketing staff. In all ECI seminars/conferences, PHILGUARANTEE officers were present to answer/respond to the queries from the exporters after each presentation.

Aside from exporter and trade associations, Seminars/briefings are also being conducted for bankers.

c. Primers/Brochures/Posters

Colorful, simplified and attractive primers/brochures containing features of the ECI program are prepared for distribution.

d. Advertisement

Advertisement in 2 or 3 widely read newspapers is one of the most effective ways of reaching a large number of exporters throughout the country. This is done at least every 6 months to maintain the visibility of PHILGUARANTEE, and to sustain the interest of exporters on the newly launched ECI program. Corporate sponsors shall be tapped to minimize costs. In addition, regular press releases will be issued to announce developments on the program.

e. Pro-Active Approach

The Marketing staff make personal calls on individual exporters and trade associations on a continuing and regular basis. This is viewed as an effective tool since during the meeting, details of the ECI may be further discussed to address certain questions of the exporter/association. Records of visits are kept on file for follow-ups. Those who have shown interest on the ECI program are being given top priority.

f. Others

PHILGUARANTEE also takes advantage of opportunities or occasions not included in its own program of activities, such as invitations to participate in, or sponsor, trade fairs, act as guest speakers or resource persons at conferences or seminars conducted by third parties, sponsorship in magazines or special newspaper supplements or press releases by other institutions/organizations.

V. UNDERWRITING PROCEDURES

The underwriting procedure basically covers the evaluation of the exporter's proposal/applications which includes information on the exporter, export product, and foreign buyer and the establishment of the appropriate premium rates and foreign buyer credit limits. Its objective is to determine whether there is reasonable spread of risk in the Portfolio of export business being offered. Below are the salient features of the underwriting procedure:

- **Processing of the Exporter Proposal/application**

In reviewing the exporter proposal application, the following areas are considered:

- ***Information on the Exporter***

Information needed to determine whether the exporter is acceptable for ECI which covers key questions on the company's general business status, experience, financial condition, and experience of PHILGUARANTEE and other banks with the exporter, if any.

- ***Information on Product and Foreign Buyers***

It is essential to know the products and services being exported and subject of coverage to determine whether it complies with the minimum requirement of local value content. Moreover, this is necessary because some products are inherently more risky due to such factors as short life cycle, potential for obsolescence or low resale value.

The underwriter determines whether the insurable risks being offered represent an acceptable spread of risk. This requires careful consideration of the level and terms of the current orders and overall proposed level of business to be covered, based on past experiences of the exporter with his buyers and markets involved.

- ***Determination of Premium Rates***

The following are the principal factors that determine the appropriate level of premium:

- Estimated volume of business
- Likely spread of business
- Likely level of Buyer risk
- Experience, competence and financial condition of the exporter
- Experience of PHILGUARANTEE with the exporter as insured policy holder
- Need to be competitive and responsive to the particular needs of an exporter

- **Establishment of Foreign Buyer Credit Limits (BCL)**

A credit limit for both the Comprehensive Shipments and Commercial Risks Only policies determines the maximum amount of loss that may be incurred for each buyer insured under the policy by PHILGUARANTEE.

Since PHILGUARANTEE has entered into a Partnership Alliance with COFACE of France and has joined the Credit Alliance Network, a credit information check on the COFACE, and

Credit Alliance Buyer Database will be made for appropriate prescriptive buyer credit limits. However, if PHILGUARANTEE finds it necessary, it may obtain additional credit information to guide its underwriting decision.

In setting or approving the BCL due consideration should be given to the Prescriptive BCL established by COFACE.

Below are some of the issues to be addressed in credit limit assessments:

- buyer's record of Payment of debts
 - record of the directors and management of the buyer in successfully managing the business
 - stability of the buyer's industry
 - exporter experience with the buyer
 - quality of the agency/bank reports
 - solvency or working capital position of the buyer
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- **Foreign Bank Underwriting**

Credit risk of foreign banks is assessed when underwriting export sales calling for Irrevocable Letter of credit (ILC) payment terms. Usually, information obtained from the Banker's Almanac and other similar publications should be sufficient. In the assessment of banks as credit risks, relevant factors to be considered are size, ownership, financial standing or rating of the issuing bank with other banks, asset quality, liquidity, and capital adequacy.

An underwriting decision will be rendered as to whether the portfolio of business bang offered will be covered or not and on what terms. Thereafter, the Underwriting Unit will review the volume of shipments covered including comparison with projected activity, reassess the country and buyer risks, relate premium paid to projected levels when the policy was issued or renewed, evaluate the claims experience and comments on the policy holders conduct in declaring insurable business and paying premium. In addition, the Underwriting Unit review existing buyer credit limits and makes recommendation for renewal or change in the amount of terms, or cancellation.

VI. CLAIMS AND RECOVERIES UNDER THE ECI PROGRAM

Once the insurance policy is issued the exporter is required to submit his monthly declaration of shipments to monitor his performance under the policy.

Assuming that the foreign buyer fails to pay his obligation on due date, the exporter should file a Notice of Overdue Account (NOA) within 60 days from due date. The submission of NOA is requested by COFACE because this is being factored in the credit information Network so that other exporters would be approved of the status of those buyers who fail to pay on due date.

If the exporter finds that running after the buyer for collection is really negative, he should then file a Request for Intervention (RI) and Notice of Claim within 120 days from due date. Again this notice will be inputted in the Credit Information Network and this will adversely affect the credit that will be made available to the defaulted buyer. What follows after submission of the RI and Notice of Claim is the waiting period. For claims amounting to US\$30,000 and more, the waiting period is 5 months. For claims amounting to less than US\$30,000, the waiting period is only 2 months. During this period, PHILGUARANTEE with COFACE will conduct an evaluation of the validity of the claim.

In case of the buyers' bankruptcy or insolvency, the exporter can immediately lay claim on the insurance subject to the submission of the necessary documents.

Upon determination that the claim is valid, PHILGUARANTEE shall immediately indemnify the exporter within 30 days from end of the waiting period.

Once payment has been made, PHILGUARANTEE will be subrogated to the right of the exporter against his foreign buyer. Any recovery made by PHILGUARANTEE by virtue of the subrogation is shared *pari-passu* with the exporter. However, expenses incurred will also be shared *pari-passu*.

VII. PROGRAM SUPPORT

A. **Philguarantee/national Government**

The ECI Program is backed by the capital resources of PHILGUARANTEE. PHILGUARANTEE's charter (PD 1080) provides that all of its obligations are fully guaranteed by the National Government.

B. **Partnership Agreement with COFACE**

PHILGUARANTEE has entered into a partnership agreement with COFACE of France. Upon signing of the Partnership Agreement with COFACE simultaneously with the launching of the program last January 1997, PHILGUARANTEE became a member of the Credit Alliance Network.

Credit Alliance is an intentional network of credit insurers in the framework of partnership agreement. The partners pool their expertise, systems and financial capacities to provide their clients with protection for their commercial debt throughout the world, providing high quality service at reduced costs.

The coverage of the services available in the Alliance are access to credit information, reinsurance and debt collection overseas.

a. Reinsurance Agreement

Any risk monitored and controlled by COFACE can be included in COFACE, reinsurance. This allows each member of the Credit Alliance to avail of the reinsurance conditions negotiated as a package deal based on supply of high premiums and regularly positive underwriting results.

b. Management Agreement

Through this agreement on-line access to COFACE, credit information database and underwriting system through computerized linkage is made possible. Payment of fees depends on the location/country of the buyer file being requested. COFACE on its part

constantly monitors and updates information and credit limits applicable on the buyer file requested.

C. **Debt Collection**

As an added service to PHILGUARANTEE, COFACE shall make available its own debt collection services for claims filed against defaulting foreign buyers. PHILGUARANTEE may also avail of COFACES worldwide debt collection network, which involves a number of debt collection agencies and law firms in different parts of the world.

D. **PHILGUARANTEE's Credit Information System**

The Comprehensive Credit Information System (OCIS) is the backbone of the ECI Program.

Internally, a foreign buyers directory is being developed. This system is envisioned to derive information on foreign buyers as gathered from various sources (e.g. trade organizations / associations, other government agencies specially those attached to the Department of Trade and Industry). This information classifies foreign buyers by source, country and product group.

The corporation has set-up a Local Area Network (LAN) to increase efficiency in processing and monitoring of exporter accounts.

VIII. OPERATING RESULTS

To date, PHILGUARANTEE, still has to issue its first policy under the Program. A lot of interest by way of inquiries has been generated through the marketing activity; and we are just awaiting the submission of requirement by the exporters to be able to come up with the proposals.

There are five BCI applications removed so far which are in different stages of processing. These applications cover an aggregate insurable amount of P338 Million or approximately US\$12 Million.

PHLGUARANTEE expects to issue its first ECI policy in the next month or so.