Chapter 11

Credit
And
Credit Instruments

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Credit

-A contractual agreement in which a borrower receives something of value now and agrees to repay the lender at some date in the future, generally with interest. The term also refers to the borrowing capacity of an individual or company. **"Borrow now, Pay Later with Interest".**

-Debtor/Borrower
-Creditor/ Lender

- **Classifications of Credit:**

➢ **According to Type of Users**

1.Consumer Credit- This a credit used by individuals to help finance or refinance the purchase of commodities for personal consumption. This is different from business credit in terms of the borrowers purpose, that is, for personal or household use.

Functions of consumer credit are:
a. Convenient for payment. Typical charge account involves purchases from a retail store that are paid once or twice amount.

b. Aids financial emergencies. Consumer credit helps consumers through period of financial stress. Some people may not have liquid assets to meet an emergency that is why consumer credit can perform valuable function in tiding a family over a financial difficulty.
c. Buying durable on installment. It aids consumer in financing the purchase of durable goods by paying for them in installments**.**

2. Mercantile Credit-sometimes also called as commercial credit, which may be described as that type of credit which one businessman may extend to another when selling goods on time for resale or commercial use, is a characteristic feature of our modern economy. Parties to a transaction involving the use of mercantile credit may be merchant distributors like wholesalers, jobbers, and producers of manufacturers. It is used in exchange of goods for the purpose of sale, whether or not the goods will undergo further processing in the hands of the buyer. Mercantile credit may be distinguished from consumer credit in the sense that the former is brought about by transactions involving the transfers of goods for business purposes, unlike the latter which is intended specifically for consumption purposes.

3. Commercial Bank Credit- differs from the preceding in terms of the parties concerned. The creditor is commercial bank while the debtor can be a business firm or private businessman. The debtor may consider commercial bank for loans in order to assist him in business operations or expansions.

4. Revolving Credit- is a combination of the charge account and the installment plan. As has been pointed out by some authors, this type of credit has developed out of the popular 90-day charge account. An addition of a service charge is made to the unpaid balance at the end of each month.

However, a fixed limit is placed on the account provided that the balance may perhaps never be cleared since the credit revolves round and round, hence, the title, revolving credit.

5. Investment Credit- is extended by banks for company who intends to purchased fixed assets- land, building equipment for business use. It is utilized by business organization for the purchase of fixed assets
or to carry minimum business operations. It consists of advances intended for the purchase or necessary plant and equipment. As such, it includes almost all the transactions whereby the capital of modern corporations, and other enterprises, is accumulated and placed at the disposal of the entrepreneur.

ACCORDING TO OBJECT OF EXCHANGE:
1. Cash
2. In kind merchandise

ACCORDING TO PURPOSE OF CREDIT :

AGRICULTURAL CREDIT- consists of the loans which are intended for the acquisition of fertilizers, pesticides, seedlings, and any instruments, machinery and other movable equipment used in the production, processing transformation, handling or transportation of agricultural products. Those loans intended to finance agricultural productions as well as for the purposes of marketing the products are included in the term agricultural credit.

INDUSTRIAL CREDIT- intended for financing the needs of industries like logging, fishing, manufacturing and others, and which involves big amounts of money. Generally speaking, as may be expected, the maturity of this type of credit is long term. The Development Bank of the Philippines grants this type of credit.

REAL ESTATE CREDIT - when credit is secured purposely for construction, acquisition, expansion or improvement of real estate properties, it is termed as real estate credit. This type of Credit was extended previously by the defunct Rehabilitation Finance Corporation which was expressly established to assist in the rehabilitation program of the government.

SOURCES OF CREDIT:

PRIVATE INDIVIDUALS- individual money lenders who loans surplus income to those in immediate need of cash. They usually do not require collateral but charge higher interest rates.

RETAIL STRORES- these outlets offer merchandise form of consumer credit. It offers a book account ("palista") for customers of the store and collection period is during paydays of the month.

PAWNSHOPS- pawnbrokers extend loans in exchange for a collateral; a pawn. Pawn acceptable is personal property or movable assets.

SAVINGS AND MORTGAGE BANKS- any corporation organized for the purpose of accumulating the savings of depositors and investing them, together with its capital ,in readily marketable bonds and debts securities; commercial papers and accounts receivables; drafts, bills of exchange and other investments and loans which the Monetary Board may determine as necessary in the furtherance of the national economic objectives.

Credit instrument- is a document evidencing the existence of a credit obligation which defines the responsibility of a debtor towards his creditor and the right of the creditor to collect from the debtor on the maturity date.

FEATURES OF A CREDIT INSTRUMENT:

1. It is a written evidence of the existence of an obligation on the part of the debtor, or a claim on the part of the creditor.

2. It shows the degree of risk that confronts the creditor with respect to the collection of the debt.

3. It shows the nature of the debtor-creditor relationship.

FUNCTIONS OF CREDIT INSTRUMENTS:

1. Written documents make claims enforceable. The credit instrument enables the creditor to hold the host instrument to collect from his debtor. The debtor on the other hand is protected of his rights with respect to the amount of the obligation, interest and maturity date.

2. Credit instruments facilitate exchange transactions. To increase volume production, producer's farmers, manufacture and merchants avail themselves credit both use of the proper credit instrument.

3. Credit instrument minimize disputes among the contracting parties. Such instruments define the extent of the obligations and claims of debtors and creditors. Once both parties are bound by the same instruments, future disputes are avoided.

4. Credit instrument facilitates production and consumption. Stocks and bonds certificates issued by corporations that are engaged in production activities. Consumers avail themselves of the use of book accounts, installment and checks to fulfill their instrument.

(2) TWO BROAD CLASSIFICATIONS

1. The credit instrument with General Acceptability

- the only instrument that meets the qualification of general acceptability is credit money. It may be in the form of bank notes or treasury certificates.

- credit instruments which all persons within a country are willing to take in payment for goods or services.

-**Credit Instruments** widely acceptable without questioning the integrity of the person offering it. The only credit instrument that meets the qualification of general acceptability is credit money.

CREDIT MONEY:

Bank Notes or Paper Money

-Issued by the Central Bank

Treasury Certificates

-a short-term obligation of the treasury, usually maturing in one year, paying interest periodically on a coupon basis: no longer issued publicly.

CREDIT MONEY QUALITIES

1.) Must be issued by a promissory in which all the people have confidence.
2). Must be in convenient denominations
3). Easily recognizable
4). Must be difficult to counterfeit.

2. The Credit Instrument with Limited Acceptability

- are issued under conditions as to make them an acceptable means of payment only within a restricted field.

-Credit Instruments for Investment Purposes are subdivided into stock certificates, bond certificates, and money market bills.

Ǻ**Stock Certificates**- Evidences of ownership in a corporation

Preferred stocks- having special privileges & carry certain limitations.

Common stocks- having entitled to residual claims on the business.

Ǻ**Bond Certificates**-Issued by a government or corporation in order to raise money

Ǻ**Money Market Bills**-Negotiable financial instruments bought and sold in the market.

-Money market- a meeting place for users and suppliers of short term funds.

Parties to a money market transaction:
a.) Fund User- ate those companies with high credit rating hat in need of funds.
b.) Fund Supplier- are individuals or corporations with excess liquidity who are looking for possible investment outlets for their excess funds.
c.) Broker- are individuals or institutions engaged in the buying and selling of money market instruments.

Kinds of Money Market Instruments

1.Interbank loans- loans which should be paid upon demand or call by the lending institutions ad have no definite maturity.
2. Promissory notes- also called dealer papers. They are short term indebtedness issued by institutions as direct obligors.
3. Repurchase agreement- are papers sold y dealers to buyers at an agreed price. The dealer undertakes to buy the same paper from the buyer at a specifies futures time and at a price agreed upon
4. Certificates of assignments- are debt instruments which evidences lawful ownership of the holder to the extent of the Peso value indicated on the face of the instruments or a batch of an original lump sum of promissory notes.
5. Certificates of participation- are debt instruments which evidence lawful ownership of the holder to the extent of the Peso value indicated on the face of the instruments or a portion of an original lump sum obligation subsequently broken down and denominated into a different Peso value.
6. Commercial papers- an instrument which is issued, endorsed, sold, transferred or conveyed to another person, or entity with or without recourse, specifying the indebtedness of any person or
entity. May either be: Financial institutions- issue the financial type of commercial paper, non-financial- public utilities agricultural and industrial firms
7. C.B.C.I. - tax-free and earn reasonable rate of interest, they are the Central Bank Certificate of Indebtedness.
8. Treasury Bills- are bearer notes of debt instruments sold every week at a discount by the Central Bank through competitive auction.
9**. C.B.P. Progress Bonds**- issued by the Development Bank of the Philippines and secured by their assets, they are tax-free and convertible.

10. Other government securities:

a. PW and Ed Bonds
b. LBP Bonds
c. Treasury Bonds
d. Treasury Notes
e. Capital Bonds
f. CCP bonds
g. ACA Notes
h. EPZA Bonds
i. Socio-economic Bonds
j. Premyo Savings Bonds
k. Biglang Bahay Bonds
l. LRT Notes
m. NDC Bonds
n. NFA Bonds
o. NAWASA Bonds

p. Bahayan Certificates

Dealer- as an intermediary in the exchange process actually becomes a party to a market transaction. He maintains an inventory of securities sells his securities to other buyers and hopes to make a profit in the process of buying and selling these securities

Broker- only acts as an agent and adviser for his clients who are either buyers or sellers, he makes them meet.

Underwriter- a dealer who handles new lines of securities. He purchases securities ad then sells them to make profit.

Transactions:
In primary market- involve the issuance of new securities.
In secondary market- are confines to already issued and outstanding securities

Dealers Intermediating in the Money Market
1. Commercial Banks
2. Savings Banks
3. Investment Houses
4. Investment Companies
5. Finance Companies
6. Securities Dealers

Investors in the Money Market
1. Individual Investors
2. Trust Funds and Pension Funds
3. Government Insurance-SSS-GSIS
4. Private Insurance Companies
5. Other government Corporations
6. Other private corporations
7. Lending Investors
8. National Government
9. Other institutions
a) Development Bank of the Philippines
b) Land Bank of the Philippines
c) Islamic Bank

b. Commercial credit instruments

Subdivisions:

Ắ**Promise-to-pay-**A promise-to-pay instrument involves two parties:

-The Maker (Debtor)
-The Payee (Creditor)

Examples: Promissory Note, Financial Institution, Deposits, Letter of Credit, Open Book Accounts

PROMISE TO PAY

1. **Open Book Account -** gives the implied verbal promise of the debtor when he buys consumable goods on credit. The creditor enters this ledger to show the existence of the credit transaction.

Advantages:

a. It is convenient.

b. It is simple.

c. The absence of legal evidence is an advantage to the debtor for he gives no written evidence for his debt, and stimulates sales on the part of the creditor.

d. It may lead to prompt payments because debtors may take advantage of cash discounts granted by the creditors.

Disadvantages:

a. It may lead to disputes and misunderstanding.

b. Payment is dependent on the debtor's voluntary action.

c. Since there is no written evidence the essentials of negotiability are lacking in this type credit instrument.

2. **Promissory note** is an unconditional written promise of the maker to pay the bearer or order a certain sum of money off at a future determinable time.

Advantages:

a. There is a tangible proof of the existence of the debt.

b. There is fixed time for payment.

c. Prompt payment can be expected rather than at the whim of the debtor.

d. It commands a higher as an asset especially for seeking, financial assistance.

e. It gives no opportunity to dispute the quality of goods purchased upon credit.

Disadvantages:

a. The inflexibility of the promissory note and its convenience of the part of the debtor has limited its use.

b. The debtor has no choice on whether to take advantage of cash discounts or not.

3. **Collateral Promissory Note.** In Similar to the ordinary promissory note but a collateral promissory note is described on its face or on a separate document. It is more secure than an ordinary promissory note in that there is some property held on deposit to assure payment of the debt.

Characteristics:

a. It contains the borrower's unconditional promise to pay the amount of the loan to the order of the lender at maturity.

b. The description of the collateral pledge is written on its face or on a separate document.

c. It contains a provision that the holder of the note has a lien to the extent of the borrower's liability on all securities and funds of the latter which are under the control of the holder of the note.

d. It may provide that upon default of payment of the note and all other liabilities will become due and payable without demand or notice, thus giving the holder the right to dispose of the collateral.

e. The holder is also given the right to transfer the note and pledge the collateral without the notice to the borrower.

f. It may contain the provision, which would require the borrower to submit the additional collateral in case the value of that is already held by the creditor declines.

4. **Collateral Letter of Credit.** It is a written promise on the part of the bank to other drafts against in or for its account, by a specified beneficiary or his order, under the specifications contained thereon.

Contents:

1. The maximum amount covered on it.

2. The length of time it will be in force that usually takes into account the period of shipment and the drawing of the drafts.

3. The documents that must be attached as well as the disposal of these so that payment may be made.

4. The quantity and quality of the merchandise to be shipped.

5. The instructions on how the drafts are to be drawn.

CLASSIFICATIONS OF LETTERS OF CREDIT:

I. According to the method of transmission:

a. Circular. A letter of credit is termed circular when the opening bank issues a letter addressed generally to person or companies indicating its intention to honor the drafts of the beneficiary under the terms specified therein.

b. Specifically Advised. On the other hand, when the opening bank notifies the beneficiary directly or through a notifying bank (usually a correspondent bank), the letter of credit is known specially advised.

II. According to the duration of the substitution of credit:

a. Revocable. Whenever the bank reserves the right to withdraw or modify the credit substantial for the buyer by such phrases as "good until cancelled" or "good until..."

b. Irrevocable. When the bank waives its right to cancel the credit or revoke the same prior to the date specified. It has a binding effect since it cannot be revoked as long as the exporter fulfills his part of the conditions specified in the letter of credit.

III. According to obligations assumed by the bank:

a. Confirmed. When the notifying or advising bank, bank upon instructions of the opening bank, assumes the obligation to perform the undertaking stipulated in the letter of credit.

b. Unconfirmed. When the advertising bank does not assume any other obligation except that of notifying the beneficiary.

IV. According to the method of reimbursement:

a. Simple. When the opening bank carries an account in the currency to paid with the paying bank, the reimbursement is simply done by book entries including service charge.

b. Reimbursement. When the paying bank prefers to receives the reimbursement by draft, or when the two banks have no inter-bank accounts.

V. According to the method of payment:

a. Negotiation. If it is a circular letter of credit, payment is termed as negotiation.

b. Straight. If it is specially advised.

c. Sight. If payments are to be made with sight or demand drafts.

d. Acceptance. If payments are to be effected with the time drafts are paid in the currency of the seller.

e. Foreign currency. If the payment should be made in foreign currency, whether that of the buyer's or not.

Ắ**Order-to-pay**-An order-to-pay instrument involves three parties:
-The Drawer- party who orders payment

-The Drawee- party ordered to pay
-The Payee- receiver of the payment

Examples:

1. Checks- A document/instrument that orders a payment of money from a bank account.

2. Drafts/Bill of Exchange-An unconditional order made by the drawer requesting the drawee to pay the payee.

3. Money Orders:

- Bank money order -order of one bank to another bank to pay a person on demand.

-Postal money order -an order of a post office to another post office to pay a person on demand.

ORDERS TO PAY

The orders to pay used in the commercial activities may come in the form of checks, drafts, or acceptances.

A. Checks - Generally, it is an order of a depositor to his bank to pay a certain amount of money to a third party of himself on demand.

- may be defined as a written order drawn by a depositor upon a bank directing it to pay on demand a specified sum of money to the bearer or to the order of some person or corporation named on the face of the check the amount against his deposit account.

Types of Checks

1. Personal Check - sometimes known as a business checks, and has the same definition as the check in general.

2. Cashier's/Manager's/Treasurer's - is one drawn by the cashier or treasurer or manager of the bank upon itself in favor of a third person.

3. Certified check - to enhance its acceptability, as the owner's credit worthiness may be doubted, the bank's certification is required by the recipient of the check. The check is then brought to the bank and the authorized representative, after checking the depositor's ledger, writes/stamps the word "CERTIFIED" followed by his signature and date of certification across the face of the check.

4. Traveler's check - used by the traveler's. Its form is different in that it comes in convenient sizes and denominations in dollar.

5. Crossed check - such check has to be deposited to the account of the payee in his bank. It may easily be recognized and distinguished by the presence of the two parallel lines appearing in the upper left hand corner of the check.

6. Post-dated-check - one issued by the drawer showing future date.

7. State check - one which has not been cashed six months after the date of issue.

8. Rubber or bouncing check - when the check is returned to the drawer.

9. Cancelled check - when the depositor's checks are finally cleared and paid by his bank.

Use and Limitations of Checks

It is a matter of common knowledge that the use of checks offers quite a number of advantages to its users

Some of the most important ones may be briefly mentioned as follows:

a. Safety and convenience. You can carry big amount of money without worries of theft and destruction. It will not be difficult to you to carry a load of money but just a piece of paper.
b. Stop-payment. The drawer of a check may send the bank a stop-payment order at any time before the cash is paid and then, under the law, the bank may not pay the check except at its own
risk.
c. Odd-amounts. Let's say a sum of P72.23 can't be in bill exactly leaving inconvenience to the payer but in checks, this amount will be given to the payee exactly including the 23 centavos.
d. Receipt. Checks can be serve as receipt of any transactions..
e. Large Amounts. Carrying big amount of money brings great danger to the person.

Indorsements on Checks

-should always be written of the bank of the checks.

A material alteration of a negotiable instrument may consist of changes in:

1) The date
2) The sum payable
3) The time or place of payment
4) The number or the relations of the parties
5) The medium or currency in which payment is to be made

Advantages of checks

1. A check facilitates payments since exact amounts can be written on it face. Thus, there is no need of splitting money into different denominations, large or small. Therefore, it is convenient medium of exchange.

2. The check serves as a receipt for payment.

3. The check is more portable than even money itself.

4. It is safer to use on certain occasions.

5. Payment can be recalled if necessary. Because of the stop payment order, one can recall or cancel payment if he is not satisfied the merchandise or if delivery is delayed.

6. The use of checks affords the owner bank accommodations, such as facilitating payment of out-of-town checks or perhaps the facility of getting a loan.

Disadvantages:

Checks owners must necessarily be very careful in issuing or handling their checks. Failure too do so cause either embarrassment of their part or loss of money. If one is not careful in keeping the stabs up-to-date, he might issue a bouncing check. The signature on the checks can also be forged or alterations can be made as to amount, date and payee.

B. DRAFTS - are orders to pay and are likewise drawn against a drawee to pay a third person a certain sum of money on demand or at a fixed determinable time.

Bills of exchange may be classified in several ways; such as according to:

1) Date of Payment.

 Demand/ sight draft- when the amount indicated on the instrument is payable upon demand or sight.
 Time draft- if payment is to be made only after a lapse of certain stipulated time.

2) Character of the Drawee

 Bank draft- if the drawee is a bank. A bank draft is an order written by one bank, directing a second bank to pay a certain sum of money to order person named in the draft.
 Commercial bank- if the drawee is a business concern. It is an order written by one person or business concern directing another to pay a certain sum of money to the person or concern named in the draft or to his "order".

3) Place where the parties reside

 Domestic draft- the parties involve reside in the country
 Foreign drafts- the drawee resides in a foreign country

4) Whether the drafts are accepted or not
 Ordinary drafts
 Accepted drafts- They may be subdivided into two:

♣ **Trade acceptance**- arises when the purchaser or importer of the goods accepts his obligations to the seller by writing the word "accepted" on the face of the draft.
♣ **Bank acceptance**- is a draft drawn upon a bank by a depositor or borrower, payable to a third party and accepted by the drawee.

5) Whether the drafts are free or documented

 Documentary draft- drafts wherein no documents are required to be attached together with the draft accompanied by the required shipping documents.

Negotiable Instruments Law

- from the ethical rules and regulations of merchants, the law governing negotiable instruments was developed.

Conditional Indorsement

-where an instrument is conditional, a party required to pay the instrument may disregard the condition and make payment to the indorsed or his transferee, whether the condition has been fulfilled or not.

TYPES OF DRAFTS

1. Money Order - may either be a bank order or a postal money order. When the order is drawn by a bank on another bank or the branch to pay a specified payee, then it is a bank money order. When the order is from one post office to another, then it is a postal money order.

2. Bank Draft - is an order to pay when the bank orders another bank or the depositor to his bank to pay a third person a definite sum of money, payable on demand or at a future determinable time.

-is an order drawn by one bank on another, directing second bank on another, directing the second bank to pay a stated sum of money to the bearer or his orders on demand or at a specified or determinable date.

3. Trade or Commercial Draft - used by merchants and may also be a demand or time draft.

4. Sight or Demand Draft - when the order to pay is payable at sight upon presentation.

5. Time Draft - when the order to pay sets a definite determinable future time of payment.

C. ACCEPTANCE - an acceptance is originally an order to pay. It is a time draft. To make sure of its payment at maturity, the draft is presented for acceptance to the drawee. If the drawee accepts, he becomes liable for the draft and in effect assumes the burden of payment at maturity.

TYPES OF ACCEPTANCES

1. Trade Acceptance - arise when the purchaser or importer of the goods accepts his obligations to the seller or exporter by writing the word "accepted" on the face of the draft.

2. Bankers Acceptance - when the order to pay is presented to a bank for its acceptance and the bank accepts the terms thereon, the bank's representative stamps the word "accepted" on the face of the draft.

Advantages of drafts and acceptances

Since these are written instruments. They likewise provide evidence of the existence of debt. A draft in bank usage also has the advantages of the check. A commercial draft is advantageous because it serves as a collection device. In foreign trade the use of drafts serves to facilitate and thus enhances the flow of goods from one country to another. Acceptance for their part, have the advantages of both orders to pay and promise to pay.

Disadvantages

In the case of acceptances, there is a danger of overtrading. It can also lead to lax credit investigation, for the seller will largely depend on the purchaser's promise to pay.

Bonds – are promises to pay the principal as well as interest to its holder at a certain specified time indicated in the instrument. Bonds represent certificates of indebtedness on the part of the corporation which issued them.

- evidences of indebtedness of a corporation to bondholders.

The needs of corporate finance, and the desire to attract the funds of all types of investors, have led to the creation of a variety of bonds which differ from one another in regard to the following.

1.The character of the security
2.The provisions governing the payment of interest and the repayment of principal;
3.The purpose for which they are issued; and
4.The nature of the issuer.

Classes of Bonds

1.Nature of the issuer
2.Nature of security
3.Maturity
4.Termination
5.Form of instrument
6.Purpose

Bonds whether secured or unsecured may also be classified with respect to the payment of the principal and interest as follows;

1.Coupon bonds
2.Retirement of bonds

Kinds of Bonds
1. Debenture Bonds- unsecured bonds issued against the general credit standing of the user.
2. Collateral trust bonds- secured by a pledge of corporate stocks and bonds, and evidences of indebtedness of other corporations which are owned by the issuing corporation.
3. Mortgage bonds- bonded indebtedness secured by a mortgage on real properties of the corporation
4. Sinking fund bonds- are bonded indebtedness requiring the compulsory maintenance of a sinking fund to redeem the bonds at maturity.
5. Registered bonds- is one which is issued in the name of a particular person or

entity.
6. Guaranteed bonds- are bonds, the principal and interest payments of which are guaranteed by a company other than the issuing corporation.
7. Convertible bonds- are bonds which could be exchanged with other securities of the corporation within the duration of the bonded indebtedness.
8. Redeemable bonds- bonds which are subject to call, redemption, or repurchase before they are due. Optional redemption are that the corporation may or may not redeem the bonds depending on the circumstance prevailing. In mandatory redemption the corporation is required to redeem the bonded indebtedness within a specified time
9. Serial bonds- bonded indebtedness of single issue but are divided into groups of different maturity dates and could possibly have variable terms and conditions
10. Income bonds- the interest payments of income bonds are dependent on the happenings of an event or after the lapse of a certain period of time.
11. Coupon bonds- bonds with detachable coupon which evidence interest obligations payable at specified periods
12. Profit-sharing bonds- are bonds allowed to participate in the earnings of the company in addition to the interest payments

Definition of 'Credit Insurance'

Credit insurance is a type of life insurance policy purchased by a borrower that pays off one or more existing debts in the event of a death, disability, or in rare cases, unemployment. Credit insurance is marketed most often as a credit card feature, with the monthly cost charging a low percentage of the card's unpaid balance.

Investopedia explains 'Credit Insurance'

Credit insurance can be a financial lifesaver in the event of certain catastrophes. However, many credit insurance policies are overpriced relative to their benefits, as well as loaded with fine print that can make it hard to collect on. If you feel that credit insurance would bring you peace of mind, be sure to read the fine print as well as compare your quote against a standard term life insurance policy.

<u>Credit Insurance?</u>

- ➔ A Credit Insurance policy guarantees policyholder will be paid for goods or services sold to its customers
- ➔ The policy insures commercial accounts receivables against non-payment.

<u>Policy Benefits</u>

- ➔ Protection against bad debt loss
- ➔ Increased sales

- ➔ Better borrowing position with insured receivables
- ➔ Credit information resource
- ➔ Collection services

<u>Effective Utilization of Policy - Benefits</u>

Protection Against Bad Debt Loss

- ➔ Maintain internal credit review
- ➔ Credit insurance information resources
- ➔ Fast moving business
    - Uses “Blanket Coverage”
    - Uses “Online Automatic Approval System”
    - Uses “Online Coverage Request System” to reach underwriters for immediate review

<u>Credit Insurance as a Profit Center</u>

Credit insurance is the only insurance product that can MAKE money for its purchaser:

1. Increased Sales
2. Lower borrowing costs
3. Replace costly letters of credit

<u>Better Borrowing Position</u>

- ➔ Credit insurance is major component of banking agreement – keeps rates down and borrowing line up
- ➔ Replace costly LC’s

<u>Credit Information Resource</u>

- ➔ Worldwide information database
- ➔ Faster insurance decisions

<u>Collection Services</u>

- ➔ Outsourcing – More cost effective
- ➔ Worldwide collection network

Key to Growth

- ➔ Ability to compete with larger companies for larger sales
- ➔ On export sales, ability to compete by offering open account terms
- ➔ Quick responses to orders
- ➔ Cost control
    - Reduction in loss reserves
    - Reduced borrowing costs
    - Outsourcing collection services

THREE TASKS OF CREDIT INSURANCE

1. Prevention and monitoring:

- Judgment solvency/creditworthiness actual and future customers of the insured.

- Permanent follow-up of the covered customers.

- Immediate communication by the PH of each default.

2. Collection/recuperation:

Collect the trade receivables in case of (unpaid) claims:

- Amicable lawsuit;

- Or judicial procedure.

3. Indemnity:

Insurance function.

- Official insolvency: bankruptcy, composition (WCO/LCE=law on the continuity of the companies dd. 31/1/2009)

- Presumed insolvency: no payment of the invoice, a certain period after the maturity date (waiting period)

-No commercial relationship with the debtor (buyer) which could lead to frustrations

-'Code of conduct' in Belgium (communication of the reason of negative decisions)

OTHER BASIC PRINCIPLES OF CREDIT INSURANCE

1. INSURANCE OF THE COMMERCIAL CREDIT RISK

What is the commercial credit risk?

Insolvency of the customer

Private debtor

A sole trader or company person which has a private law statute

2. INSURANCE OF THE GLOBAL TURNOVER OF THE COMPANY

Basic reasoning: avoid that a company arranges a systematic selection of the risk, and only insures its bad risks.

3. PARTICIPATION OF THE INSURED (85 %)

in the loss of the trade receivables:

- term of the «good house father» and of «partnership»
- No insurance at 100%

4. POSSIBILITY OF CESSION OF THE ADVANTAGE OF THE POLICY

In favour of a third: Bank, factoring company...

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