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## Credit Insurance Contract Policies As Vital Instruments To Encourage International Trade: An Urgent Need For The Amendment Of The Cima Code.

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### ABSTRACT

Globalization has inadvertently led to an excessive increase of international trade between states. This alleged increase in international trade has certain short comings, since, most exporters and manufacturers do supply goods and services on credit basis. Sometimes, debtors allegedly fail to pay their debts, and this might lead inexorably to the winding up of concerned companies. As a desperate means to boost international trade, by merely protecting potential manufacturers or suppliers, countries have overwhelmingly adopted insurance legislations, that inadvertently allow insurers to cover these insurable risks through what is known as trade credit insurance contracts. Unfortunately, the CIMA Code which realistically is the main insurance legislation applicable in its member states and Cameroon in particular, is silent on the adequate protection of companies, through credit insurance contracts and, therefore discouraging suppliers to be competitive internationally, since, they can't export products on credit basis without credit insurance contracts cover. As a result, the objective of this article is to examine how credit insurance contracts protect companies against unpaid debts and the urgent need for the amendment of the CIMA Code.

**KEYWORDS:** Credit Insurance, Contract Policy, International Trade

## Introduction

Risk has been precisely defined as a possible hazard or chance of loss. In insurance context, risk is broadly referred to a somewhat pessimistic sense, in that one has in mind the possibility of loss or misfortune.<sup>2</sup> With globalization, suppliers and manufacturers have established confidence with partners all over the globe. They abundantly supply goods and services on credits, ostensibly based on trustworthiness of their potential partners. However, since we can't live without possible risks, these prominent manufacturers or suppliers might end up without properly recovering outstanding debts for good and services generously supplied to their debtors. This might invariably lead to the winding up of these concerned companies.

As a means to protect these manufacturers or suppliers, credit insurance contract policies have been introduced as legal instrument to protect creditors. Credit insurance policy contract is one amongst other general insurance contract policy. A contract can be defined as an agreement between two or more parties, that creates rights and obligation enforceable by law. Insurance contract in common, is a contract of adhesion, where, the insurer, draft the terms of the contract through what is allegedly known as a policy form which then binds the insured and insurer. The policy form which covers the terms of the contract between the insured and insurer, is considered as a contract made between the proposer and the insurer, recorded in a document called a policy.<sup>3</sup> The policy is the evidence of a contract of insurance and in the event of a dispute, it is the policy to which the court's attention will be drawn.<sup>4</sup>

Therefore, insurance can be considered as a contract whereby an individual, called the insurer, accepts to cover risk, in exchange for a given amount or consideration, called the premium to pay to another person, called the insured or policyholder, a sum of money on the happening of a specified event or loss. With globalization, enterprises and individuals are exposed to contemporary forms of risks and to cope with these risks, insurance companies have proposed certain insurance policies. Among these covers proposed by insurance companies, we typically have credit insurance policy. Credit insurance contract policy represents a type of general insurance policy that covers creditors against the risk of non-payment of debt for goods or services supplied to debtors.

Credit insurance contract policy allows companies to feel secure in extending more credit to customers, or to pursue new, larger customers base internationally, that would have otherwise seemed extremely risky, since, in case of non-payment of debt, they will be indemnified. The protection credit insurance contract policy adequately provides, is that, it allows a company to increase sales to enlarge their business with existing customers and therefore encouraging exportation, which is a vital instrument, to be competitive at the international market. Regrettably, the CIMA Code which correctly is the prime piece of legislation that governs insurance activities in Cameroon and its member states has been silent on this critical issue, therefore directly hindering national companies to expand their sales and affects exportation. Even Cameroonian legislators, who undoubtedly have the competent to enact such laws, where there's a vacuum have also been silent

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<sup>2</sup>Ashly Babu, "*Role of insurance in construction and infrastructure*", International Journal of civil engineering and technology 5, N<sup>o</sup> 12, DEC (2014) p, 206

<sup>3</sup> Caroline Aturu-Aghedo, *principles and practice of insurance* (Lagos: national Open University press, 2009), 2.

<sup>4</sup> See article 9 of the CIMA Code. The policy is not the contract itself. But merely indicates that the contract arising from the agreement reached by the parties.

## The Scope of Credit Insurance Contract Policy

Insurance contract policies are always drafted by an expert underwriter. The underwriter usually takes into consideration circumstances typically surrounding the products or services to be insured, so that the premium should be able to sufficiently cover the potential loss. Since, an insurance contract is a contract of adhesion, the underwriter drafts the policy, by which, the insured discloses vital information relating to the subject matter of insurance, so that, the insurer should be aware of the subject matter to be insured.

Underwriting of an insurance contract is traditionally based on a possible variety of criteria, established by each insurer and regulated by the CIMA code<sup>5</sup> Each underwriting decision of credit insurance contract is based on bringing equilibrium between the proposed premium, and the ability to cover claims in case of loss without the insurance company going out of liquidity.<sup>6</sup> Underwriting can be defined as the function to scrutinize every proposal for insurance and decide whether the risk proposed for insurance may be accepted or rejected, and if accepted, on what terms<sup>7</sup> Underwriting is the foundation of insurance contracts.<sup>8</sup>

Credit insurance contract policy is not drafted in a standardized form like automobile insurance. Credit insurance contracts are drafted on an individual basis, based on the credit risk exposed by each insured.

Since, insuring trade credit is extremely crucial, a key feature of credit insurance contract underwriting process, is the accurate assessment of creditworthiness of the insured and monitoring of the policyholder's customers (insured debtors), assigning them, each a credit limit, which endure the amount the insurer will allegedly protect, if the debtor fails to discharge the outstanding debt.

Before accepting the offer of the insured, the insurer monitors the insured business, utilizing a variety of sources, which include;

- Analysing the financial statements of the insured company.
- Information supplied by other policyholders or insurance companies that sell credit insurance cover to the same customer (insured).
- Public records.
- Past due reports.
- Precise Geographical location of debtors (if they are in stable country).

<sup>5</sup> See article 212 of the CIMA Code

<sup>6</sup> Richard Radevsky, Doug Scott, *Pipeline Insurance: Technical Aspects Of Underwriting And Claims* (Institution of Civil Engineers, London, 2004) p 2. They should remain in compliance with regulatory financial requirements while making a profit.

<sup>7</sup> <http://capeschool.com/htmcrlastly> visited on the 4/09/2017 It can also be seen as evaluating the subject of insurance, whether a person, property, profession, business, or other entity, determining whether to insure it or not

<sup>8</sup> The underwriter must apply company standards to each applicant, and, based on these standards, ascertain whether the application represents an acceptable risks.

Buying a credit insurance contract policy, gives the insurer access to an extensive information network, which act as an effective prior warning mechanism for adverse customer trends. Unlike other types of general insurance policy, once a credit insurance policy is taken out, the relationship between the insurer and the business/policyholder does not remain static until the termination of an insurance contract. Throughout the operational lifetime of the policy, the credit insurer will solemnly inform the policy holder of any necessary changes that might severely impact the financial health of their customers and their cognitive ability to pay them for goods or services delivered. They will subsequently establish a plan with the policy holder to mitigate risk.<sup>9</sup>

The specific terms of insurance contract may instantly change over the lifetime of the policy to accurately reflect the financial situation of any potential customer (insured) and it is the responsibility of the insurer to proactively follow up its policyholders, to ensure their continued creditworthiness, utilizing the credible sources mentioned above.

During this specified period in which the policy is promptly running, an insured might reasonable request for an additional credit insurance contract coverage from the insurer. The credit insurance underwriter will then evaluate the risk of increasing cover and either approve or decline the additional credit limit requested, with a lucid and timely explanation.

#### **Types of credit insurance contracts policy.**

As earlier said, credit insurance contract policy, in common is a Business to Business type of insurance contract providing cover against the risk of not being paid for goods or services that companies give out to their customers on credit basis. If customers (debtors) do not pay, the loss is covered by the insurance contract policy. The insurance contract policy gives confidence to commercial companies to naturally extend credit to new customers and also improves access to funding, from financial institutions, since banking institutions usually request a convincing proof of credit insurance contract policy before financing certain projects.

With credit insurance contract policy, commercial companies have the choice to choose a contract policy that protect against commercial risk or political risks which are beyond their control, knowing that in case of non-payment of debts by debtors, they will be indemnified. This helps commercial companies to grow profitably and equally compete at the international market through a considerable increase in exportation, since, in case of insolvency or protracted default (non-payment of a debt within the agreed credit period), they will be indemnified by the insurer.

Credit insurance contract policy usually covers two main types of risk (insurable risks or perils) that a commercial company can choose. They properly include commercial risks and political risks.

- Commercial Risk

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<sup>9</sup> Association of British Insurer, 2016 Trade Credit Insurance Guide

Commercial risk includes risk that company's debtors are unable to pay outstanding invoices they borrowed from the company because of financial reasons. For example, insolvency of debtors

- Political Risk

Since ~~most of these debtors operate~~ in diverse countries, as a means to protect commercial companies against non-payment of debts by debtors, insurance companies have included political risk as insured perils in credit insurance contract policy form. Political risk involves non-payment of debt as a result of events outside customer's control, due to political events, such as wars, revolutions, disasters, earthquakes, hurricanes or economic difficulties, such as a currency shortage that may cause problems transferring money owed from one country to another.

looking at credit insurance contract policy, insurable perils include commercial and political risks cited above. However, primordially are certain perils which are not covered under credit insurance contracts and these perils are known as exclusion perils, which are not included in a credit insurance contract policy form. These perils include.

- **Currency Devaluation:** In a situation where there is a deliberate downward adjustment to the value of a country's currency relative to another currency, group of currencies, the insured won't be indemnified under credit insurance.
- **Any derivatives:** Where there is a loss due to the fluctuation of prices of stocks and commodity in the market, such risks are not covered under credit insurance contracts, since they are speculative and uninsurable risks.
- **Sanctioned countries:** Exclusion clauses in credit insurance contract policy additionally include, the non-payment of debt by a debtor or debtors living in a country or countries where there are political trade restrictions put in place against such state with the ultimate aim of properly maintaining or restoring international peace and security. For classic example, economic sanctions imposed on Russia due to the imminent invasion of Ukraine.
- **Unenforceable debt:** When a statute of limitation for debt collection has unanimously passed by the legislature, a creditor is no longer allowed by law to keep chasing a debt that's statute has barred.

Credit insurance contract policy offers flexible products to meet the needs of unique companies to the extend, that, they can expand sufficiently the terms of the contract by an endorsement of additional terms known as exceptional perils. Policies are carefully designed to adequately protect individual risks exposed by policyholders and properly provide an effective range of options which include:

## 1. Comprehensive Credit Insurance Contract Policy

It is moreover perceived as All Risk Insurance Contract Policy, since it involves a broad range of risks across both domestic and export transactions.

## 2. Optional Credit Insurance Contract Policy

It is called optional because this insurance contract covers only certain business risks. They are optional, since they adequately provide excellent cover for key buyers only: either on an individual basis or as essential part of a smaller portfolio of key risks.

### 3. Specific Credit Insurance Contract Policy

It is a specific type of credit insurance contract policy where, the practical terms of the contract are carefully tailored because of an urgent need in the market. This can be perceived, where there is an increasing market for supplying goods and services on credit, which undoubtedly have specific requirements that trade credit insurers can provide peculiar solutions for.

There are different types of credit insurance contract policies drafted by insurance companies in most countries that accommodate the needs of companies. These credit insurance contract policies include;

#### A. Single Risk/Buyer

It is a credit insurance contract policy that adequately covers a peculiar isolated risk. This policy is relevant if the policyholder is exposed to a specific market risk, like delivery of a particular stock of goods or when a credit insurance contract is requested by the bank financing the transaction. The bank will request for a tangible proof, that such risk in which they are financing has been properly protected by credit insurance contract policy. In such a situation, the company can request for a Single Risk/Buyer credit insurance cover.

#### B. Export

Companies usually export goods to debtors in different countries and in situation of non-payment of these debts, the company will face heavy financial loss. As a means to protect exporters, a credit insurance contract policy has been specifically designed for exporting companies and provides additional cover by a means of endorsement on the policy form for exceptional risks such as import restrictions, war and inconvertibility of exchange.<sup>10</sup>

#### C. Multinational

Most companies that operate today all over the globe are multinational companies. These companies may supply goods and services to trustworthy customers on credit basis. As a means to protect these multinational companies against non-payment of debts, there is the need for a credit insurance contract policy that will protect all the branches of this multinational company against default payment of debt. This contract policy properly provides multinational companies worldwide cover under similar conditions, irrespective of the location of the business units.

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<sup>10</sup> See article 7 of the CIMA Code

## **D. Political Risk**

Since companies do supply goods and services to customers in other countries or regions on credit basis, these debtors may end up without paying these creditors due to political instability. Insurance companies have offered credit insurance contract policy on political risks as a means of protecting companies against unforeseen political risks such as riot, war, civil commotion, import and export restriction, etc.

## **E. Excess of Loss**

It is a credit insurance contract policy that adequately covers for exceptional losses over and above the average level of bad debt by setting an aggregate first loss for the whole policy period. It is sometimes referred to as a “Catastrophe contract policy” aiming to carefully secure the Policyholder against the failure to pay debt by major buyers.

### **Importance of credit insurance contract**

Credit insurance contract policies are of considerable importance to businesses, whether they are trading domestically or internationally. Some of these benefits include;

#### **a. Increasing Sales**

Credit insurance contract policy help companies to secure sales on credit to more customers or expand sales to new customers on credit basis, that may otherwise have been deemed too risky, knowing they are insured and in situation of non-payment, they will be indemnified by the insurance company.

#### **b. Discovery of potential international markets**

Credit insurance contract policy helps protect companies against the risks of exporting overseas by protecting unforeseen circumstances that might happen in the course of doing business. Credit Insurers does not only protect non-payment of debts, but advice policyholders on the market situation, since they have access to real-time

information on business intelligence worldwide and access to information is a key factor to any firm trying to expand into new territories.

#### **c. As an incentive for banks to grant loan**

Credit insurance contract policy usually acts as an incentive for banks to grant loan, since banks usually gives out loans to companies who possess trade credit insurance contract policy cover. Credit insurance contract policy usually acts as a prerequisite in order to be qualify for an asset-based loan in a bank.

#### **d. Protecting companies against insolvency**

If a customer is incapable to discharge its debts due to insolvency or protracted default, trade credit insurance will pay out a percentage of the outstanding amount owed (typically around 90%). This

enhances business access to cash in the event of a default, which means that cash continues to flow and significantly reduces a risk to the company of going out of liquidation.

## Lapses of the CIMA code

The CIMA code is a piece of legislation that regulate insurance activities in its member states and Cameroon in particular. The CIMA code is divided in five books, however, the CIMA code has a vacuum as far as general insurance products are concern. Not only the CIMA Code, states are unable to enact national laws that will regulate the protection of company debts. With all the advantages accruing from credit insurance contract policy cited above, if the CIMA code is not amended, with credit insurance contract policy included in it, companies operating within its member states, will be reluctant to export goods on credit basis, therefore directly hindering development in it member states, leading to a balance of payment deficit.

The CIMA code needs a drastic amendment to accommodate the outrageous demand of global insurance market today. Looking at this code, by which, member states need to adhere to, it can be perceived that, the code is extremely scanty and the legislative arm of member states haven't adopted insurance laws to secure national companies that export goods on credit.

Looking at book 1 of the CIMA code, it carefully examined insurance contracts, that is, conclusion and proof of insurance contract form and transmission of the policy.

Book 2, talk on compulsory insurance, which is based merely on automobile insurance. Focusing exclusively on automobile insurance by an insurance code that regulate insurance activities in member states is not appropriate, since automobile insurance is just one amongst other types of general insurance contracts.

So, if the CIMA code can't be amended to adequately protect creditors, each member state need to eagerly adopt a law that will adequately regulate credit insurance contracts.

## Conclusion

Carefully looking at all the merits accruing from credit insurance contract policy, it is deemed that, this policy contract, is an ultimate shield to protect companies against non-payment of debts. Since, it is amongst the rare insurance cover protecting political risks link to non-payment of debt. Therefore, there's the need for the CIMA code to be adequately amended or national legislation should adopt insurance law that will protect commercial companies against non-payment of debts.

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