FINANCIAL RISK INSURANCE

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Abstract:

Insuring financial risks is part of the sphere of property insurance being generated by the economic and financial relations that develop between the economic agents domestically and internationally and by the debtor's ability to cope with his obligations at due settling date in the relations with the creditor.

In conducting the commercial transactions, the risks are inevitable being higher in the external transactions. The financial risk is the potential prejudice to which are subject the interests and entrepreneurial activity in the commercial transactions of sales and purchase, execution of works or provision of services.

The insurance system for financial risks contains more products: credit insurance, financial risk insurance form, destined to protect the bankers for the borrowed amounts to customers and the traders and producers against financial damage resulting from the insolvability of buyers who have purchased goods on credit, guarantee insurance by which the insurer joins the insured to warrant towards the creditor the fulfillment by the insured of his contractual obligations, fidelity insurance, this offers the insured protection against certain damages generated by the confidence granted to the insured personnel that administrates the company assets.

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1. INTRODUCTION

The commercial activity is by definition subject to various risks. Each year tens or hundreds of thousands of companies worldwide turn bankrupt remaining with large debts to the partners; quite often this is due to the insolvency of buyers, making it impossible to recover the concerned amounts and therefore the series of problems continues and overflows on others.

Most traders conclude and run commercial transactions without protecting against this real threat: not to charge the value of the sold goods or provided services from buyers. In the current period, talking about international markets, we refer to "global markets", uncertainty receives new dimensions and forms of manifestation. In a highly competitive business environment, success is largely conditioned by the customers' solvency.

Natural persons, companies and even countries resort to loans, scrolling transactions or investments using credit, which largely explains even the economic development itself.

Although credit primarily means trust, it is however necessary to protect creditors for the risk of not recovering the amounts lent. This is made by a form of insurance of financial losses. Insurances related to business, influenced by the economic situation and the possibility of the buyer to acquit the payment obligations at maturity, are known as financial and political risk insurance. The name comes from the fact that losses of money are covered, and not the property damage or liability. Due to the characteristics of risks and specific assessment methods, these types of insurance are not usually part the objects of activity of the ordinary insurance companies, but practiced by the specialized companies.[5]

The failure to pay the amounts owed by the public importers can also be considered of political nature.

Currency risk arises when performing an export with deadline payment there are used two currencies: e.g. the contract is concluded in the currency of the supplier's country

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(or the currency of a third country) and the payment of delivery by the external buyer is paid in the currency of his country.

Changing the relationship between the two currencies in the time between signing the contract and until paying the supplies, can result in losses for the supplier and gain for the buyer or vice versa..

2. THE IMPORTANCE FOR INSURANCE IN ECONOMY

To counteract the risks of the export on credit, providers do extensive investigations on the potential customers' solvency before signing up the contract and then use various tools and financial and legal work techniques. Suppliers cannot be safe of all the export risks and they call upon protection by insurance.

In some cases, not even the classical insurance can provide full protection to suppliers engaged in exports with dead line payment or to the banks that grant loans to external buyers. This is the case of political risks arising from the measures taken by the public authorities of the importing country and that are of insurable nature. The same insurable character bears the risk of non-payment posed by the public debtors and against whom no coercive measures may be taken to make them meet their obligations.

When the classical insurance cannot take the political risks that threaten the national providers, the state intervenes in addition to or in lieu thereof. The institutions acting by the power of attorney and for the State take various legal forms of state administration departments, public institutions, insurance companies with status of private law.

In our country, for ensuring and guaranteeing the export credits there has been created the Export Import Bank of Romania (EXMINBANK) which began the activity in 1992.

In terms of how state intervenes in the export credit insurance, the international practice knows different solutions.

Financial insurances are a relatively new form of insurance issued as a consequence of the process of narrowing the distinction between the financial institutions and the insurance ones. It is a new concept by which the insured eliminates the risk of financial loss that may occur in his/her activity, transferring them to an insurer.

The commercial credit represents both the value transferred to the buyer by a seller on trust and the time before the reimbursement of the value by the purchaser as payment.

Financial insurances are different from bank guarantees. By financial insurances the risks are taken over only under certain conditions, while the bank guarantees involve unconditionally assuming all obligations.

The commercial guarantees that come from the need of the persons responsible to offer guarantees against non-payments have begun to be used thousands of years ago. Such a guarantee was provided through one or more private guarantees, who assumed responsibility for the risk of non-payment. Such a system was considered inadequate and even convicted for the guarantor.

The guarantees offered by the companies acting as guarantor have multiple advantages. The first company in England who practiced this system has been Guarantee Society in 1840. Subsequently, other insurers have started practicing or have been established in various forms of association to practice this type of insurance, using different kinds of policies, either individually or in groups.

Based on the Civil Code of Switzerland, in 1934 there was established the International Association of Credit and Investment, known as the Berne Union, aimed at accelerating the free exchange of information on country risk and establishing certain healthy principles and rules and discipline in international trade and in the export credit insurance and foreign investment.

Credit insurance is a special insurance because it has a much different purpose than other types of general insurances. The credit insurances are undoubtedly a characteristic of the contemporary business world.

The credit insurance protects traders and manufacturers against the risk of non-payment by customers purchasing or renting goods or receiving similar credit facilities. It appeared as a necessity stemming from the fact that the vast majority of trade contracts concluded in the circumstances in which payment is made partially or totally after the delivery of the goods or services covered by the agreement, so with deferred payment, i.e. “credit sale”. Thus, credit insurance comes to eliminate the seller’s fear on non-payment by the buyer of the amounts due to him, providing security for the risk of -payment. The reason may be the financial situation of the buyer or, if the sale takes place in a country other than that in which the seller is, causes related to the situation of the importing country. The credit insurance appears as direct protection of sellers against the risk of not collecting and at the same time as a guarantee to the bank, being a possibility of access the financing.

The insurance can be done on a single credit or turnover.

The purpose of the credit insurance is to protect against financial losses resulting from non-payment, default payment or insolvency of the buyers who purchased goods on credit or insolvency of credit beneficiaries. Through credit insurance policies there are protected the cashing from the commercial activities in terms of transferring the risks of not collecting on the insurer and, consequently, it can increase turnover.

Insuring the credits is considered a luxury insurance, it is characteristic and properly operating within the market economies, with a stable and well developed credit system. Globally, most credit insurances are practiced in the developed countries.[4]

Credit insurers typically provide a wide range of services along with the insurance ones, such as: market researches, consulting, technical assistance, feasibility studies, investigation and supervision of loans. Among the risks insured there may also be encountered some less accepted in the market, such as: currency risk, expropriation risk, restrictions for fund transfer, etc.

Although insurances against such risks are available in the national and international insurance markets, only a relatively small number of traders worldwide appeal to them.

It is important to note that regardless of the size of the risk, there are three requirements for insured persons:[2]

1. Prevention by collecting, processing and interpreting the information on customers in order to minimize the risk of non-payment;

2. Debt collection, namely the ability to recover the debts anywhere in the world, regardless of their language, culture or legal system;

3. Insurance, namely the payment of compensation in case of non-payment of the debtor to the insured.

The insurable risks can be grouped into two categories:

1. Commercial risks, which are related to the purchaser's financial situation and covers: [1]

a) non-payment due to insolvency of the buyer

The insolvency may be determined by various causes, such as: bankruptcy; any measure of enforcement on the debtor's property that has not led to full payment of the invoiced amounts in favor of the insured; enforcement of a court decision for approval of the arrangement between the debtor and his/her creditors; concordat without judicial proceedings with all creditors or the majority of them; suspension or official moratorium on payments owed by the debtor or any similar measures under the law of the debtor’s country.

b) temporary or permanent impossibility of the buyer to pay for purchased goods or provided services.

c) buyer's refusal to accept the contracted goods for reasons beyond the seller.

2. Political risk, which is a separate category, but very important to correctly assess the possibility of returning the credit and implicitly of the risk of non-payment. This risk occurs only in export credit insurance. It can be determined mainly by the "subjective elements" existing in the importer's country. By producing one of the risks related to that country, the entire contractual relationship between the partners may be damaged. The political risk may result in:

a) difficulties and delays (longer than a certain number of days, usually 180) in the transfer process of money from the buyer's country as a result of a general moratorium, regarding the external debt, declared by the government of buyer's country through which payment is made;

b) the impossibility to transfer those amounts from the importer's country to the exporter's country due to government actions in that country (the buyer's) preventing the performance of the export contract or determining delays in transferring the money;

c) introduction of regulations on export or import licenses into buyer's country, withdrawal or non-renewal of the export license or imposing trade restrictions, after the entry date into risk;

d) war, civil war and other similar events outside the exporter's country, which make it impossible to fulfill the export contract if the damage is not insurable as commercial risk;

e) risks on public buyers; public buyers means those entities that cannot be declared bankrupt;

f) losses resulting from the impossiblity to institute legal proceedings in the buyer's country because of the lack or poor functioning of the legal system in that country

In particular, for the export credit insurance, the insurable risks are dangers resulting from selling goods or providing services on credit abroad.

Prolonged non-payment is a risk that can affect the financial situation of the insured. It is considered an event of late payment when the debtor or guarantor did not pay part of the debt in a certain aggregated period, usually 6 months from the maturity specified in the agreement. The force majeure care, difficulties in transferring money, insufficiency of convertible estimates or other political reasons, natural disasters, epidemics or any form of violence in society are in principle exempt.

Together with the protection necessary to exporters for the risks that may affect transactions on medium and long term, the insurance policy facilitates the access to financing, representing a guarantee for the financing bank and removing a significant part of the risk.

The excluded risks for which the insurer will not pay compensation may be:[3]

- complaints in respect of inadequate good delivery or provided services;
- penalties or any other losses related to the non-performance of contractual obligations under the sale and purchase agreement concluded by the seller (insured) with the buyer;
- fines of any kind;
- losses from foreign exchange differences;
- compensation due to political risks;
- compensation following a declared war or undeclared civil war, revolution, rebellion, sabotage etc;

- damages due to natural disasters (cyclone, flood, earthquake, outpouring sea, hurricane, tornado or other similar events with catastrophe character), if the technical means available to fight such disasters have not been used or have been ineffective.

This type of insurance includes mainly the following:

• credit insurances, namely domestic credit insurance, export credit insurance, credit rates insurance and investment credit insurance.

• Loyalty insurance

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3. CONCLUSIONS

The credit insurances eliminates in a certain measure the substantial risk of financial loss, especially when dealing with transactions of large amounts or the number of business partners is relatively low; this can cause a difficult situation where one or more debtors cannot acquit their payment obligations. However, not all credit insurances are always profitable, especially if the individual loans are lower and the risks are dispersed on a high turnover.

The credit insurance is compensation insurance, as it involves compensation paid to the insured for the suffered loss due to insolvency or default of the insured's customer, and not the creation of a ”physical” event as the case of the other insurances. Therefore, it is a pecuniary insurance, of financial loss and not material.

The differences between ordinary insurance, indemnity insurance and credit risk come from nature of the risk and the stakeholders, namely:

1. There are 3 parts involved in credit insurance, each aware of the other.

2. The responsibility lies on the repayment of the debtor's credit and the liability only if the first does not fulfill his/her payment obligation due to reasons included in the insurance policy.

3. The insurer has no interest in the agreement, than the guarantor for the buyer.

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