THE INTERNET AND THE CREDIT INSURANCE

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Abstract: Credit insurance provides companies with coverage four outstanding commercial recivables, protecting against risk of buyer default or insolvency. In adition to managing credit risk, credit insurance supports financing needs: by reducing the risk of non-payment of trade recivables, a firm can borrow at lower interest rates.

keys: e-marketplace, e-business, internet

1. Introduction

The outlook for credit insurer is promising. Credit insurers enjoy a significant competitive advantage due to their vast expertise in credit risk management and their proprietary databases on millions of companies worldwide. This expertise and information on trade recivables is the basis for underwriting credit risk. It can be used to provide new services to credit departments, in addition to credit insurance.

Credit insurers are beginning to provide new products an to unbundle existing products by separately providing information and risk coverage. Related services such as invoicing and debt collection, are providing additional sources of earnings.

The internet is facilitating these developments by providing a less expensive distribution channel and high-speed communication to support services such as claims adjustment. The explosive growth of business to business internet transactions is providing an opportunity for credit insurers and other credit service companies. By providing lines of credit to buyers on the internet, credit insurers are enhancing their fee-based revenue by leveraging their proprietary information of the credit worthiness of buyers. Finally, the growing market for derivates and asset backed securities presents opportunities and challenges for credit insurers. Credit insurers can provide asset specific credit enhancement, particularly for the underlying assets of the asset backed commercial paper of the trade recivables.

The internet provides new opportunities and challenges to credit insurers.

Currently, credit insurance companies are utilizing the internet in three different ways. First, they can use the communications features of the internet to improve client communication and reduce costs. Second, they can market, sell and manage their traditional credit insurance via the internet. Third they can provide new products for the rapidly growing volume of e-commerce, particularly business-to-business(B2B) internet sales.

2. New technologies are helping to reduce costs

Besides being an important information and communication medium, the internet has developed into a powerful distribution channel, which can improve client communication and reduce costs.

The internet can help insurance companies deliver high quality, personalized information to their clients. It can also help in reducing paper work and other costs related to processing information and forms by doing the work online. The increasing use of the internet by insurers is expected to improve efficiency in underwriting, distribution, administration and claims settlement, which will be reflected in lower costs for insurers. According to a recent study [35] on e-business, its greater use could lead to about 9% costs savings in commercial lines. We expect that the cost saving for credit insurance could be about the same. There is some potential for extraordinary savings for credit insurers on underwriting, but only after a large amount of expenditure on information technology.

3. Traditional credit insurance can be provided via internet

Providing traditional credit insurance via the internet is fairly straightforward, though it faces potential technical and regulatory hurdles. It is technologically feasible to match a company's customer to a credit

[35] Swiss Re, " *The impact of e-business on the insurance industry: Pressure to adapt-chance to reinvent*", Sigma No 5/2000.

rating database and provide some indicative pricing on a credit insurance policy. The data needed from the credit insurance client are company identification, value of sale and data of sale. Unknown companies would need to be eliminated from the price of the credit insurance. In addition, credit insurers can use the internet to enhance the quality of their services, for example by improving communications with clients and speeding the claim process. For many years now, technological developments have been improving the electronic exchange of information between the insurer and the insured.

However, there will remain frequent personal interactions between the policy holder and the insurance provider.

The credit insurance companies are devising new and innovative solutions for the growing volume B2B transactions over the internet. Internet sales of products in the B2B market have been growing rapidly. The turnover of internet trading between companies was estimated to be USD 150 billion worldwide in 1999, and USD 7,3 trillion by 2004.

The growth of internet B2B sales has accompanied by a growing number of anonymous transactions on e-commerce marketplaces (e-marketplaces), substantially increasing credit risk. Credit insurers has recognized this and devised differing business models to mitigate the risks associated with the extension of trade credit on the internet .

4. Two business strategy

Credit insurance companies bundle two similar and related services for their clients. The first service is the provision of information on buyers. The insurance companies have collected huge amounts of information on the credit worthiness of business all over the world. This information is used by the insurers to price premiums and is also supplied to clients to help them manage their trade recivables. The second service provided by the credit insurers is the risk coverage that protects the sellers against default by the buyers. These two services can be packaged together or separately, providing two strategy or models.

The first strategy relies more on the credit insurer’s information advantage. In this model, the insurers unbundled their services and provide information separately from their information product. The credit insurers’ rate firms included in their databases and sell these ratings to their clients and e-marketplace. Lesser known, or new, firms can pay a fee to an insurer to be rated. Since the insurer continue to provide insurance products, the clients can choose whether they want to buy information services alone or information bundled with insurance.

Large business seeking for self-insure and to reduce the cost of monitoring theirs costumers or suppliers will only purchase information services from the credit insurers. Small firms that find credit insurance too expensive may also buy only ratings from the insurer. The emphasis in the business model is on providing information services to a larger market than is currently interested in credit insurance. Though, not necessarily related to the internet, this business model lends itself to providing other unbundled services, such as invoicing and debt collection, to support credit departments.

In the second model, instead of providing information risk coverage separately, these services are provided together. Normally, in this model the credit insurer insures the entire e-marketplace with which it has a relationship. All transactions on the insured e-marketplace are covered. This is similar to traditional credit insurance, which generally covers the whole turnover of large clients with a diverse portfolio of buyers.

In e-business the credit insurer extends credit limits to buyers in the e-marketplace. The size of the firm does not matter as long as it is doing business at an e-market place covered by the insurer. This business model has a lot in common with the consumer credit card market. The e-marketplace brings buyers and sellers together, deriving its revenue from fees added on to sales. For example, the e-marketplace might be a conduit for sellers of automobile parts to vehicle manufactures and the auto parts after-market.

Alternatively the e-marketplace site might sell only one’s company product line to many buyers, as in a computer parts company selling to computer manufacturers. Buyers are accepted if they have a credit limit set by the credit insurer or other acceptable firm. The financial firm that provides the credit line and guarantees the sell receives a portion of the sales fee from the e-marketplace, in much the same way that credit cards companies receive a portion of all sales involving use of their credit card. The financial firm, such as credit insurer, can work with the e-marketplace to provide Credit Certificates to all customers using the site for purchases. A payment guarantee ensures that the seller will receive even if the buyer defaults.

Alternatively, the financial firm could work with buyers, providing credit limits directly to them for use on any site affiliated with the financial service.

In either case, buyers are also assigned a spending limit, based on data to be provided by buyers and credit information agencies. The credit providing agency will also monitor payments, deducting the value of a transaction from the credit limit after a purchase, and adding it back after the invoice has been paid. This product involves information on the buyers and risk coverage for the sellers.

Though there is a great overlap in company strategies, the large credit insurers have somewhat different approaches to the internet. Coface is using the internet to enhance its relationships with important clients, and a large proportion of their credit limit requests and policy amendments are now handled online, improving service and reducing costs. In January 2000, Coface launched an internet-based commercial debt rating system called @rating which markets information about buyers to sellers. Coface's ratings are based on its database of payment recordsfor over 32 million companies. Coface has trading partenerships with Wisekey, a leading internet service provider, and Tradecard, an online payment and settlement software company. Coface also sells insurance to clients and e-commerce marketplaces.

Euler's e-commerce strategy consists of servicing existing clients as well as providing insurance for internet transactions. For internet services, Euler primarily uses its Online Information Service (EOLIS) to manage the insurance policies of their clients. Customers can check outstanding limit on existing clients, track claims field, check information on potential customers and even get automatic responses to requests for extensions in credit limits.

For internet transactions Euler provides insurance for all transactions of an e-marketplace.

Gerling Kredit provides insurance for the entire selling chain. In addition to the electronic business-to-business transactions it also offers insurance for the electronic business to consumer transactions. Within the electronic business-to-busines segment, Gerling Kredit provides online service to its existing clients by Net&Serve and has recently created Trusted Trade GMBH, a new company aimed at insuring business-to-busines transactions. Trusted Trade provides credit insurance for entire e-marketplaces. In addition Trusted Shops, another company affiliated to Gerling Kredit, protects online consumers form a company's failure to deliver goods or damaged delivery of goods.

NCM provides its online services through an affiliated company, eCredible.com. eCredible.com's offering consists of two elements: credit management services and the eCredible Payment Guarantee. The key element of credit management services is the credit certificate that is issued to the sellers current customers or new prospects to authenticate the buyers credit worthiness. Buyers are also assigned a spending limit, based on data provided by buyers as well as from credit information agencies or NCM's database. NCM also updates the balance on the buyer's account, deducting the value of a trasnsaction from this spending limit and adding to the limit the value of payments on the accounts. The eCredible Payment Guarantee ensures that the sellers will receive payment if the buyer defaults.

5. Competitive issues

Some firms, such as Dun&Bradstreet, compete with credit insurers by providing company credit information. In November 1999, Dun&Bradstreet launched its electronic joint venture, eccelerate.com, with internet trust services provider VeriSign. The group facilitates e-commerce trading by providing unique, secure identifiers and access to credit checks. Digital certificates, similar to the Payment Guarantee provided by eCredible.com, contain a company identifier and pre-qualify a firm to conduct e-commerce on a range of exchanges, online auctions and procurement sites.

The internet has made access to vast amounts of information easier and less costly than previously. The ease of access and competitive pricing may pose a significant challenge to credit insurance companies which have always exploited the value of their company databases. Some company information is publicly available- this is how information service providers like Dun&Bradstreet hve built their databases- and can be supplemented with information solicited directly from companies. The credit insurers have a vast amount of proprietary information based on actual transactions, which should prove to be a better source of information on future payment practices. The credit insurers can leverage this proprietary information to their advantage. Also, credit insurers have experience in underwriting transactions and debt collection which can provide significant value to credit management departments.

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