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A Study on Improvement of Import Insurance for Importers

Kim, Jae Seong*

Key Words : Import Insurance, K-sure, Insurance Clauses, Credit Risk, Consignment Processing Trade

Ⅰ. Introduction

South Korea, despite the recent financial turbulences from the EU and US, has marked the trade volume of USD 1 trillion in 2011 and in 2012, the county overtook Italy to be the world's 8th largest trader and 7th largest

* Ph. D. Adjunct Professor, Dept. of International Trade, Baewha Women's Univ.

exporter.

The world economy, on the contrary, has been still slowing. In this context, the Korean economy will need diversified trade assistance policies to overcome crises as it only becomes harder for it to grow incessantly and achieve USD 2 trillion trade mark in a shorter time in a situation as this. For economic stimulation, not just export policies but also import assistance policies are necessary.

According to the 2012 KITA statistics, approximately 40% of the entire import of Korea was for export. In the South Korean trade structure, import and export are closely related, requiring proactive import financial assistance policies.

Recognizing this, K-sure has made import insurance policy available on the market since July 2010. The K-sure insurance policy targets both financial institutions and importers.

Initially, the import policy started with the capital of KRW 4.6 bln in 2010, recording KRW 21.6 bln for importers, KRW 1 trl 854.8 bln for financial institutions as of August 2013, marking the total of KRW 1 trl 876.3 bln.[1)]

In a short period of time, the import insurance policy has earned a remarkable achievement. Looking more closely into this achievement, however, we can see most of the performance came from financial institutions while only little from importers.

In the context where L/C-based trading practices have decreased and remittance-based deals are on the rise, import insurance for importers is essential to help remove smaller importers' credit risks.

This research seeks to review the import insurance terms for importers and compare with foreign import insurance products to find out ways to improve.

Previous researches on import insurance are as follows. First, Ju Tae Lee

1) www.ksure.or.kr

and Byung-Soo Ahn reviewed South Korea's import insurance characteristics and investigated general awareness on import insurance, reasons not to use it and requirement for insurance use.[2]

Based on this analysis, we suggested several methods to facilitate the use of import policies and further to contribute to a balanced trade practice. For stable supply of resources of which importation is unstable, we suggested herein why import insurance is beneficial for prepayment-involving transactions and why it is more favorable than trade finance and loan.

Secondly, Seung Gyun Yoo, and Soo Beon Han looked at South Korea's trade developments and import insurance mostly by comparing with Japan's import insurance and presented improvement methods.[3]

Third, Byung Kyu Choi introduced South Korea's import insurance for its significance, contents and corresponding terms while presenting problems and improvement of the current system.[4]

The present research is different from previous literatures in that while the latter is mostly about import insurance introduction, improvement and effectiveness, the present research is to address problems and improvements of import insurance terms for importers.

Ⅱ. Significance and Current Status of Import Insurance

1. Significance and Role of Important Insurance

2) Ju Tae Lee · Byung Soo Ahn, "Study on the Way of Using Korean Import Insurance according its Characteristics", *Korea trade review, Vol.37, No.5*, 2012.

3) Seung Gyun Yoo · Soo Beon Han, "A Study on the Development for Import Insurance in Korea", *Journal of International Trade and Insurance Vol.13, No.4,* Dec 2012.

4) Byung Kyu Choi, "A study on problems of import credit insurance and some reform suggestions", *COMMERCIAL CASES REVIEW, Vol.25, No.2*, 2012.

Import insurance is to give importers financial assistance and compensate their loss in case where products are not received due to a foreign exporter's failure to honor the contract or where prepayment is not collected. Import insurance plays the following roles.

First, import insurance assists national economic policy implementation. Import insurance is a non-profit insurance products for the good of national people, necessary to effectively import and supply essential resources to the people.

Secondly, it reinforces assistance to exporters who import resources for re-exportation. As Korea's export has a close relationship between raw material import and finished good export, import assistance can work effectively as export assistance.

Third, such as policy expresses the Korean government's commitment to a balanced trade to the outside. South Korea has seen trade surplus since 2000 continuously. In this context if the government announces such a policy it also reveals the government's commitment to realizing a more balanced trade practice to the outside world.

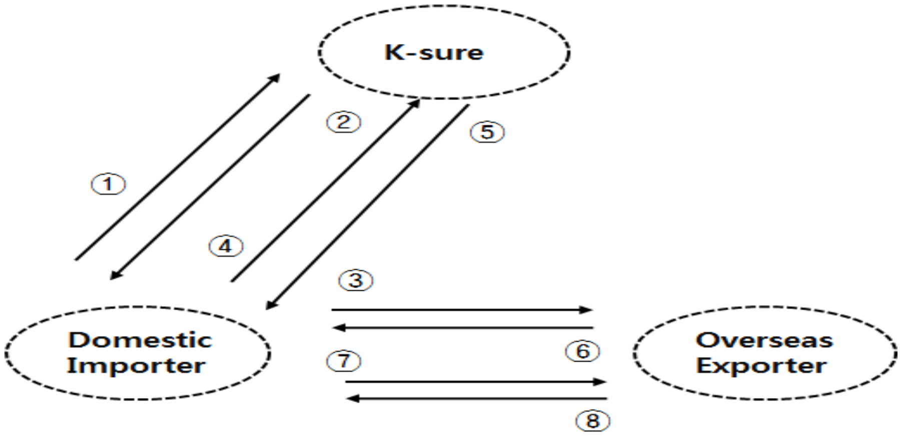
2. Types of Import Insurance

1) Import Insurance for Importers

Import insurance for importers covers a possible loss caused when a domestic importer paid to its overseas counterpart before goods shipment but fails to receive goods.

The insurance targets are limited to key resources such as iron, copper, coal, crude oil, etc. and machinery, hitech-products, exchange earning material, etc. described in the Customs Law. And covered deals should be import transactions where shipment will be made within 2 years after prepayment. The scope of loss is limited to the prepaid amount not collected.

〈Figure 1〉 Process of Import insurance for Importers



① Credit investigation of foreign exporter
and Offering Insurance Contract
② Issuing Insurance Policy
③ Pay pre-payment
④ Notification of Paying pre-payment
and paid Insurance Premiums
⑤ Notification of Formation of Insurance
⑥ Failure of Export
⑦ Demand for Refund of pre-payment
⑧ Refund of pre-payment (or pay claims amount)

2) Import Insurance for Financial Institutions

The insurance product for financial institutions covers losses incurred when a financial institution lends import capital to a domestic importer but it is not repaid. The institutional products' coverage and terms are similar to a guarantee product.

This product normally targets transactions with less than 1-year loan period while exceptionally allowing over 1-year period deals. For Usance L/C, the letter should be first issued and the issuing details should be notified for its acceptance after accepting of shipping documents. Insurance benefit payment is the principle and pre-set interest rate and the same regardless of corporate size.

3. Characteristics of Import Insurance

Import insurance product is different from export insurance as follows.

First, import insurance limits its scope of assistance and targeted coverage items. Its targeted import deals are only resource and goods that are significant to the national economy. Covered items are selected as those necessary for national infrastructure industry development and stable economic activity of people. It has about 70 different major resources including crude oil, iron, coal, etc.

As for raw materials imported to earn foreign money are excluded from import insurance coverage because these are already subject to the export credit guarantee system under the foreign trade management rules of the country.

Secondly, import insurance also excludes intermediary trades from its benefit coverage. This is because its targeted import transactions are only resources and goods essential to the national economy. Intermediary deals do not bringing in goods to the country, thus presenting only poor relation with the national economy.

Third, import insurance only accepts and impose premium on deals that are informed to K-sure after an importer made a prepayment or a bank lent import capital. Also if the loan is repaid before its due, the import insurance refunds the amount corresponding to the shortened insurance period.

4. Status of Import Insurance Use

K-sure has operated the import insurance product on the market since July 2000. In the first year of 2010, as shown in 〈Table 1〉, its underwriting performance recorded a mere KRW 4.6 bln. but it rose to KRW 21.5 bln in

2012 for importer insurance and KRW 1876.3 bln for financial institutions, reaching almost KRW 2 trl which is a huge jump.

As described in 〈Table 1〉, institutional insurance products show rising underwriting amount, number of underwriting cases, premium amount, etc. But the importers' product plunged from KRW 41.284 bln in 2010 to RKW 274 mil in 2011 and rebounded temporarily to KRW 21.488 mil in 2012 then started to fall again.

〈Table 1〉 Sums of Import Insurance

(unit : mil)

	2010	2011	2012	2013. 8
Institution	9,384	1,332,293	1,854,799	1,792,734
Importer	40,284	274	21,488	1,538
Sums	49,667	1,332,567	1,876,287	1,273,921

source : Statistics of K-sure Import Insurance.

Ⅲ. Outline of Import Insurance Terms for Importers

1. Import Insurance for Importers

K-sure's import insurance for importers is to cover a loss of a policyholder when the policyholder or importer domestically addressed made a prepayment but cannot receive goods.

2. Scope of Application

The import insurance is applied to import transactions of goods or resources stated in insurance terms to be shipped within 2 years after the prepayment, excluding intermediary trade.

There are targets under the import insurance for importers as follows:

① Key resources

② Facility material/items for pollutant release prevention or for waste disposal

③ Cuttingedge products(excluding state-of-art technologies)

④ Raw materials for earning foreign money

⑤ Goods recognized by K-sure as necessary

3. Covered Items

The import insurance for importers covers emergency risks and credit risks. The emergency risks, here are as follows:

1) limit or prohibition of foreign exchange transactions performed in foreign countries(the country of an importer's counterpart),
2) impossibility to conducts foreign exchange transactions due to foreign war, revolution, rebellion and other equivalent events,
3) measures exempting or disturbing prepayment of foreign government, state government, local government or laws and regulations,
4) acceptance by foreign government, state government or local government,
5) economic sanctions by international organization or a 3^{rd} country,
6) accord to delay repayment according to government-level agreement or foreign remittance delay due to areas on attributable to a foreign country,
7) reasons other than 1) through 6) above taking place outside Korea that are not attributable to the import contacting party(excluding a case where an export license acquired or necessary to acquire for insurance contracting loses its effectiveness due to its accompanied terms or expiration).

Credit risks are as follows;

1) import counterpart's in solvency to repay the pre-payment, and
2) import counterpart's pre-payment refund delay.

4. Exemption

The import insurance for importers exempts the following cases.

1) loss from credit risk in headquarters' transactions,
2) loss exceeding the limit of benefit,
3) loss caused by a policyholder's making prepayment when the prepayment of which due came (the first refund due according to an import contract), was not refunded until 30 days after the refund date within 1 year retrospectively from the prepayment date, in import transactions on condition of prepayment with the identical import counterpart (including transactions not insured for this product),
4) loss incurred in relation with import goods' destruction, damage, capture, defect, etc.
5) loss in relation to bonds a policy holder acquired against law,
6) loss from transactions inappropriate for the policy coverage or for the insurance terms, and
7) loss from risk that has already occurred before the insurance contract.

Ⅳ. Improvements of Import Insurance for Importers

1. Expansion of Coverage

Japan's import insurance has not set any specific regulations on the items applicable for the import insurance coverage.[5)]

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5) Japan revised its Export Insurance Act to Trade Insurance Act in 1987 and commercialized

Also Netherlands has had prepayment insurance and processing insurance covering product supply, manufacture goods and even bonds and guarantees.

In the case of South Korea, for the past 5 years, its consignment processing trade has increased continuously since 2007. The growth trend has slowed temporarily due to the 2008 US and 2010 EU-led financial distresses.

But still consignment processing trade have been on the rising track in terms of export amount.

Here, K-sure's import insurance coverage needs to be expanded to intermediary trade and consignment processing trade, etc. As and insurance is underwritten after exporters' credit ratings, it seems not effective to put a limit on coverable items.

2. Awareness Improvement on Import Insurance for Importers

Import insurance has remarkably grown after its implementation in July 2010. The insurance amount was only KRW 49.667 bln in 2010 but it jumped to KRW 1 tril. 794.272 bln in 2013, reaching almost KRW 2 trl.

With this successful performance, import insurance has gained great

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import insurance in NEXI from 1988. Japan's import insurance is called futures import insurance.

The futures import insurance is a system to cover a uncollectable prepayment claimed for return by an importer when the importer cannot actually import the contracted goods after the importer made part or whole amount of the prepayment before goods' shipment according to contracts.

Japan's import insurance is mainly characterized as follows.

1) the futures import insurance covers only import contracts with shipment within 10 years after prepayment,
2) covered risks are limited to emergency risk and credit risk,
3) import contracts should have shipment within 10 years after prepayment.
4) no specific limit is on the coverage of imported goods,
5) credit risks are limited to those with security rate of 97.5% and credit risk of 90%. The upper limit of futures amount of emergency risk varies from JPY 2 mil to JPY 20 bln according to national credit ranking. Credit risk is limited up to JPY 20 bln.

attention. Such figures, however, in import insurance represent mostly the performance of import insurance for financial institutions.

Import insurance for importers recorded KRW 40.283 bln inn 2010 and plummeted to KRW 274 mil in 2011. Its use as of October 2013 is KRW 1.538 bln, showing a reduction.

There are diverse reasons for such a reduction in import insurance for importers and one of them is the lack of importers' awareness on import insurance.

In this sense, the following methods will be necessary. The insurance product should be continuously promoted. Cooperation from trade-related organizations will be necessary. A more systematic educational program should be introduced about K-sure's import insurance.

3. Reinforcement of K-Sure's Roles

Prepayment is a very useful tool for secure raw material and resource supply of which supply and demand are unstable. Supply reduction due to seasonal factors or rapid demand surge make raw material supply unstable.

To stabilize this trade, prepayment methods should be chosen strategically. However, importers who should make prepayment are, especially when they are smaller firms, easily exposed to a credit risk and emergency risk.

Therefore K-sure should set up a more preemptive import insurance assistance system for smaller-sized enterprises.

4. Necessity to Revise Import Insurance for Importers

Terms of import insurance for importers holds more provisions unfavorable to policy holders than other insurance terms. Import insurance mostly is bought by companies but not all of them are large firms and most of them are smaller and weaker parties in contracts.

To better protect them, the terms of import insurance for importers need to reflect other normal insurance terms after appropriate modification.[6)]

Ⅴ. Conclusion

South Korea, despite the financial turbulences has marked the trade volume of USD 1 trillion for 3 years and marked 7th largest exporter in 2013. The world economy has been still slowing. We need diversified trade assistance policies to overcome crises as it only becomes harder for it to grow incessantly and achieve USD2-trillion trade mark in 2020.

Approximately 40% of the entire import of Korea was for export. In the South Korean trade structure, import and export are closely related, requiring proactive import financial assistance policies.

Recognizing this, K-sure has made import insurance policy available on the market since July 2010. The K-sure insurance policy targets both financial institutions and importers.

As L/C-based trading practices have decreased and remittance-based deals are on the rise, import insurance for importers is essential to help remove smaller importers' credit risks.

This is the reason why this research seeks to review the import insurance terms for importers and compare with foreign import insurance products to find out ways to improve.

K-sure's import insurance for importers is to cover a loss of a policyholder when the policyholder or importer domestically addressed made a prepayment but cannot receive goods.

The import insurance is applied to import transactions of goods or resources stated in insurance terms to be shipped within 2 years after the prepayment, excluding intermediary trade.

6) Byung Kyu Choi, *op. cit.*, p. 547.

K–sure's import insurance coverage needs to be expanded to intermediary trade and consignment processing trade, etc. As and insurance is underwritten after exporters' credit ratings, it seems not effective to put a limit on coverable items.

There are diverse reasons to cover risk. In this sense, the insurance product should be continuously promoted. Cooperation from trade–related organizations will be necessary. A more systematic educational program should be introduced about K–sure's import insurance.

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ABSTRACT

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South Korea, despite the financial turbulences has marked the trade volume of USD 1 trillion and marked 7^{th} largest exporter in 2013.

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The import insurance is applied to import transactions of goods or resources.

K-sure's import insurance coverage needs to be expanded to intermediary trade and consignment processing trade, etc.

In this sense, a more systematic educational program should be introduced about K-sure's import insurance.

Key Words : Import Insurance, K-sure, Insurance Clauses, Credit Risk, Consignment Processing Trade