International risk team

Mitigation in Trade Credit Insurance

The measures taken by governments around the world to halt the spread of COVID-19 are already having a significant impact on the global economy. The prohibitions on trade, and closures of businesses, unfortunately mean that an increase in defaults and insolvencies is inevitable. Trade Credit Insurers are accustomed to working with their Insureds to mitigate loss, but the current situation may call for a rethink on some of the approaches commonly used.

Trade Credit policies require policyholders to exercise due diligence in seeking to minimise loss prior to payment of a claim. Insurers generally expect their Insureds to use the waiting period to make these efforts, with the primary focus being on avoiding the need to claim under the Policy. Although Insurers expect to be kept informed during this period they may steer clear of active involvement until it is clear that a claim will be presented, and/or they have formed a view on coverage. Given the Trade Credit market's experience in managing exposure, it may be that Insurers now need to have an earlier involvement in loss mitigation than would usually be the case.

Managing default

In normal economic times, policyholders may not want to rush to take steps to stop trade with their buyers. Even if the Policy contains provisions requiring the Insured to stop shipments to defaulting buyers, the Insured may ask for consent to continue trade. If the buyer is encountering temporary cash flow problems, and is capable of recovery, Insurers may grant this request, recognising that stopping deliveries to a defaulting buyer may speed up its demise and therefore increase the risk of a claim. It is to the benefit of all parties if the counterparties can survive, with their trading relationships intact. However, the current crisis means that continuation of trade may not always be possible. In that case, the focus is likely to be on securing cash flow, with every link in the chain keen to protect its own position in order to ensure survival.

In addition to situations in which the debtors genuinely cannot pay, policyholders may see an increase in situations where the cash is available but the debtor is unwilling to pay its debts, choosing to retain its funds in order to meet salaries and other expenses. Other measures offered, such as allowing suppliers to take back their stock may be of limited assistance where suppliers have already paid for the materials and labour to create them, and where they have no retail platform for any onward sale, although securing their goods may give suppliers some assets with which to protect their position. Even if buyers do not refuse outright to pay, suppliers may face increasing requests to reschedule debts, grant longer payment periods or agree haircuts, which will then have an impact on their own viability.

Insurers may need to give quick input as to advisable steps, balancing the possibility of long-term survival of the debtor against the risk that delay in taking steps will see other creditors stripping the debtor's available cash. These decisions can only be made if there is full engagement with the Insured and a full understanding of the circumstances of the buyer. Given the likely volume of claims and the need for fast action, it is possible that considerations of business continuity may not be possible, and that the focus instead is on taking all available steps to maximise the cash flow in to the Insured. This may involve robust enforcement of collection practices and early commencement of legal action, to the extent that the court system in the relevant jurisdiction remains available. Insurers will also need to ensure that this increased involvement in pre-claim discussions does not prejudice their position on coverage, given that there may be reasons why claims arising from the loss are not covered.

Impact of insolvency

It is regrettably likely that a number of businesses will fail in the coming months. The focus of Insurers and Insureds in these cases should be on maximising the prospect of recovery in the insolvency proceedings. Insurers should encourage their policyholders to make sure that all paperwork is in order and that any steps required in the insolvency proceedings are taken promptly, so that the claim is admitted in full.

Where an Insured benefits from a retention of title clause, steps will need to be taken to obtain all possible protection. This may be difficult in circumstances where the Insured cannot physically access the debtor's premises to recover stock and, as above, the ability to resell may be limited. Regaining the stock may however be considered to be more beneficial than relying on a claim in the insolvency; even if it does not assist with short term cash flow, it gives the Insured a tangible asset which may of use in the future. The Insured should take steps to bring the retention of title to the attention of the insolvency practitioner without delay, providing all possible information through which the goods can be identified and emphasising that the Insured does not consent to those goods being used unless this leads to the debt being discharged.

Conclusion

The COVID-19 crisis is causing uncertainty worldwide. No sector is unaffected, and the Trade Credit sector may be affected more than most. Early engagement with policyholders is crucial in order for Insurers and their Insureds to deal with the likely scramble for cash we will see as the effect of the restrictions deepens.

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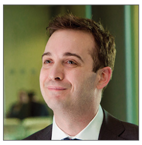

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