TRADE CREDIT INSURANCE AND COVID-19: FRIEND OR FOE?

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COVID-19 is likely to have a significant medium- to long-term economic impact on Thailand's exporters, sellers and traders. This is likely to be manifested in delayed payments or defaults. To what extent can trade credit insurance assist companies dealing with these increased risks?

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HOW COULD TRADE CREDIT INSURANCE HELP?

Trade credit insurance provides coverage for a defined percentage of outstanding amounts which become due and payable during the policy period. This is intended to protect sellers from non-payment caused by a risk or event covered by the policy. The combined and cumulative impact of supply chain disruption, government-ordered curfews, lockdowns and delays or defaults in payment are likely to contribute to an increase in claims under trade credit insurance policies.

Trade credit insurance policies will typically include a range of exclusions from and limitations to coverage and focus on these rather than on the default of the buyer as the trigger for coverage. Trade credit policies do not typically exclude cover for pandemics and the extent to which the impact of COVID-19 and government responses and measures to prevent transmission are an excluded risk will depend on the policy wording.

Trade credit insurance can increasingly be used as security for loans and other forms of financing, particularly given the exponential and recent growth of online transactions.

One area where trade credit insurance can more directly assist insured exporters, sellers and traders is in providing risk analysis and management and the tools required for risk analysis and management. Export credit agencies which offer trade credit insurance can also assist with market analysis and developments. The extent to which such services are provided and the extent to which insureds rely on these services will have an impact on the aspects of coverage are discussed below.

Thai law does not recognise the concept of a prudent insured and the focus is primarily on the duty of insured and insurer to act in good faith. The pace of infection and transmission and the speed, extent, nature and impact of government responses and measures to prevent transmission are likely to play a significant role in determining whether an insured has acted in good faith in any dispute over coverage.

The grounds for claims should be carefully considered by insureds and insurers alike.

THE DEVIL IS IN THE DETAIL

Government-ordered curfews and lockdowns

Many companies will seek to rely on government-ordered curfews and lockdowns and their effect as grounds for not complying with their payment obligations. This would include the orders of the governments of Thailand, its fellow ASEAN members and key trading partners to impose curfews, lockdowns and other restrictions on movement and commercial operations.

A critical and typical exclusion is for claims where the orders or regulations of the seller's government prevent compliance with contractual obligations and/or payment of outstanding amounts. In relation to this exclusion, it is important to be able to identify how directly claims flow from compliance with the government orders rather than from the broader economic impact. The Thai government ordered certain businesses and industries to remain open, such as factories and banks, and others to remain open with restrictions or be closed, such as department stores and shopping centres. Claims arising from compliance with these policies will need to be assessed on their facts and circumstances. The greater and more direct the nexus between compliance with the government orders and an inability to comply with contractual payment obligations, the more likely that claims made under a policy with such an exclusion will not be covered. The impact of curfews and lockdowns will vary but it is important to ensure that specific causes are separated from broader economic conditions, including the COVID-19 slowdown and potential recession.

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It is also important to consider whether Thai law would consider a breach of a requirement under the policy sufficient to entitle insurers to terminate policies or limit or exclude cover. The position is less clear and certain in Thai law-governed policies than for policies under English law.

Valid underlying contract

Many policies also require the underlying sales contract to be valid and enforceable and that transactions be covered by the policy. Although this appears uncontroversial, it can result in claims being rejected on grounds including that the underlying contract was not executed, not properly executed or that the transaction was not covered by the policy. In addition, any express or implied term or agreement excusing a breach of the payment terms could breach this requirement. Any variation to payment terms, including extending payment periods, should be carefully considered and documented.

Non-disclosure

A key focus is likely to be on changes to the insured creditor's credit control and management policies and procedures. Where a change is considered material, this may create an obligation of disclosure. Changes to payment terms could constitute a material change in these policies and procedures and are likely to be closely scrutinised in the event of a claim.

Variations to payment terms could also result in disputes over non-disclosure, particularly where trade credit insurers may seek to deny coverage on the basis that knowledge of the buyer's financial position and resulting risks should have been more accurately and fully disclosed before inception of the policy. Such disputes have regularly arisen in more favourable economic conditions than the current market conditions. In the current economic environment, insurers may seek to decline cover on the basis that a more objective and rigorous analysis of the buyer should have identified the risks which have subsequently manifested in the buyer's failure to comply with the payment terms.

The position of insurers may be weakened by reliance on independent financial analysis of the buyer prior to policy inception or in circumstances where the insurer has provided risk and market analysis to the insured. Insurers may also need to consider the extent to which they have accepted policy cover for similar claims involving the same seller and/or buyer, particularly where insurers did not previously raise any issue of non-disclosure and/or did not require details of the buyer's financial position.

A further issue to consider is the extent to which an insured was required to notify its insurers of the impact of COVID-19 on their business and whether a failure to do so constitutes a material non-disclosure under a trade credit policy.

Prior knowledge

Claims arising from the impact of COVID-19 and measures to prevent its transmission may also give rise to disputes over prior knowledge of an insured. To some degree this overlaps with the issue of notification to insurers of the impact of COVID-19 in the context of disclosure of material facts. In relation to the prior knowledge of an insured, the issue is likely to be the extent to which an insured had knowledge of a buyer's failure to comply with payment terms, particularly in circumstances where the issues causing the buyer's default arose during, or out of an initial or early stage of COVID-19 and/or measures to prevent its transmission. The speed of infection, rate of transmission and the speed, extent, nature and impact of government responses and measures to prevent transmission are likely to be critical factors in relation to the prior knowledge of an insured.

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Compliance with debt collection procedures in the underlying contract

Disputes over coverage may also arise from a failure by an insured to comply with the debt collection procedures in the underlying contract. As noted above, any variation to the payment terms should be considered carefully and be fully documented. The position is likely to be more complicated where the past conduct of a buyer and seller has resulted in informal variation to stated payment terms and a pattern of conduct by the seller waiving compliance with these requirements.

IN THE BIGGER PICTURE

The broader economic impact of COVID-19 and government responses and measures to prevent transmission are likely to play a critical role in claims handling and resolution. The Thai Office of the Insurance Commission has already indicated that it expects insurers to treat claims arising out COVID-19 favourably and sympathetically. In such circumstances, Thai insurers may have even more limited ability to dispute and decline claims and the key issue for Thai insurers will be the extent to which their exposure is reinsured and the extent to which the reinsurers are willing to indemnify Thai insurers for claims for which liability has not been conclusively established.

In this regard, the duty of an insurer to act in good faith may also require insurers to carefully assess claims and grounds to decline cover. This is particularly in circumstances where claims may be covered by other policies, such as business interruption insurance.

A prompt and favourable response by Thai insurers and their reinsurers may result in a greater long-term acceptance of the role and need for trade credit insurance. COVID-19 claims paid today could result in better long term take up rates and higher premiums in the long term.

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