Maximizing Coverage Under Trade Credit Insurance Policies

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Trade Credit Insurance

January 28th, 2015 | Written by Peter Halprin

Trade Credit Insurance Policies are designed to protect policyholders in the event that a domestic or overseas customer or financing recipient becomes insolvent or defaults upon a payment. A number of insurance companies sell this insurance to help policyholders reduce their risks in international (as well as domestic) trade. Policyholders, however, can face significant hurdles when trying to recover insurance proceeds even in the event of a covered cause of loss. We highlight here a potential challenge for policyholders and suggest ways in which policyholders can maximize their recovery in light of this challenge.

According to the World Bank, “Trade credit insurance (also known as credit insurance, business credit insurance or export credit insurance) is an insurance policy and risk management product that covers the payment risk resulting from the delivery of goods and services.” Trade credit insurance, as defined in this article, refers to insurance against the failure to pay trade debts in connection with a specific transaction or a portfolio of transactions or operations. It is distinguished here from accounts receivable insurance, which is designed to protect companies against loss on receivables.

Potential policyholders for such policies include commodity traders, banks and financial institutions, forfaiters, contractors, and exporters.

Trade Credit Insurance is marketed by insurance companies as, for example:

1. covering up to 90 percent of a contract’s value, substantially reducing a company’s exposure and enabling them to trade with confidence;
2. acting as a safety net, protecting businesses from defaulting customers and the bad debts which would otherwise arise when a customer is unable to pay;
3. playing a proactive role in helping companies trade more securely, as the insurance company

can help businesses make good risk decisions about whom to trade with;

4. protecting companies in circumstances where a potential partner is uninsurable or where previously granted insurance cover is withdrawn, whereby the insurance company acts as an "early warning signal" alerting policyholders to potential trading risks;
5. making policyholders more attractive to banks, which will look more favorably upon funding requests, often enabling the policyholder to negotiate better financing terms.

While trade credit insurance may hold advantages for policyholders, recovering under such policies is all too often a challenge.

Insurance Companies Often Argue Non-Disclosure Defense to Avoid Paying Claims

One of the greatest challenges for policyholders is in trade credit policy provisions that void coverage *ab initio* where a policyholder allegedly made misrepresentations in the application for insurance. In some instances, this duty is ongoing and extends throughout the policy period.

For example, one trade credit policy form requires the policyholder to warrant, among other things, that (a) as of the execution of this Insurance Policy, it has no knowledge of any circumstance which could give rise to or increase the likelihood of a Loss; and (b) all of the information that it has provided and will provide to the Underwriter including, but not limited to, the information provided in the Application for Insurance, is and will be true and that no material information has been or will be withheld.

1. New York Law on Non-Disclosure

Under New York law, which often applies to such policies, an insurance company may rescind an insurance policy that was issued in reliance upon a material misrepresentation. To rescind a policy of insurance, the insurance company has the burden of proving that the applicant for insurance made a misrepresentation and that the insurance company would not have issued the policy had it known the truth. The New York Insurance Law defines a "misrepresentation" as a false statement "as to past or present fact, made to the [insurance company] by, or by the authority of, the applicant for insurance or the prospective insured, at or before the making of the insurance contract as an inducement to the making thereof." *See* N.Y. Ins. Law § 3105(a). A misrepresentation may be a false statement or a failure to disclose where a duty to disclose exists. There is however, no duty to volunteer information unless a question plainly and directly requires it to be furnished.

Under the New York Insurance Law, "No misrepresentation shall avoid any contract of insurance or defeat recovery thereunder unless such misrepresentation was material" and "[n]o misrepresentation shall be deemed material unless knowledge by the [insurance company] of the facts misrepresented would have led to a refusal by the [insurance company] to make such contract…." *See* N.Y. Ins. Law § 3105(b)(1).

Thus materiality becomes critically important in a dispute regarding non-disclosure.

1. English Law on Non-Disclosure

Under English law, which often applies to such policies involving international trade, because insurance contracts are 'of the utmost good faith', the policyholder is required to disclose all 'material' facts to the insurance company even if no question is asked by the insurance company. What is 'material' is any fact or circumstance which would influence the judgment of a prudent insurance company in fixing the premium or determining whether it will insure the risk. Where an insurance company raises a non-disclosure defense, the burden of proof is on the insurance company to establish that a material circumstance was known to the policyholder but not disclosed, and that had this circumstance been disclosed, the insurance company would either not have entered into the insurance contract or would have entered into it on different terms.

In practice, if the insurance company is able to establish that a material circumstance was not disclosed, then there is a presumption that the insurance company would not have entered into the contract or would have entered into it on different terms. The burden then shifts to the policyholder to establish that had the particular circumstance been known to the insurance company when it agreed to take the risk, it would have written the business anyway on the same terms as those which were in fact offered. If an insurance company succeeds in establishing a non-disclosure defense, then it can avoid or rescind the contract of insurance.

English insurance law, however, is currently being revised, and the new law is said to soften the current law so as to avoid the "harsh" current remedy of rescission.

Maximizing Coverage in the Face of a Non-Disclosure Defense

To avoid the "harsh remedy," three strategies can be helpful both at the outset and once one finds oneself in a post-loss dispute.

A. Disclose, Disclose, Disclose

Applications for such insurance require detailed financial information such as sales data, debts, credit exposure, and payment terms for all of the parties, and sometimes even proposed parties to the underlying transactions. Policyholders should make expansive disclosures with regard to such information and work closely with joint insureds, additional insureds, and any other potential partner in the transaction to make a full and complete disclosure.

B. Be Helpful

Policyholders and their brokers should always ask the insurance companies if they need anything further or if they have any further questions. If the insurance companies do not respond in the affirmative, this helps to establish a record of helpfulness and reasonableness on the part of the policyholder, and the satisfaction of any queries on the part of the insurance company. Periodic inquiries of this nature through binding, as well as updates on the status of a deal, will further this narrative.

C. Materiality – No Harm, No Foul

Insurance companies may raise the non-disclosure defense even if a claim is otherwise valid. Under such circumstances, materiality becomes a key issue. It is a fact-intensive query and can require extensive discovery. The policyholder can look to prior transactions with the same insurance company, either with the same policyholder or with another policyholder underwriting the same risk, to make the case that the policy would have been issued in the same manner if the disclosure had been made. Internal insurance company materials such as underwriting manuals and guidelines will also be helpful in this respect.

Conclusion

Because non-disclosure is the easiest defense for an insurance company to raise in these cases, particularly in the context of transaction-specific insurance, policyholders must start thinking about this issue from the outset. A proactive and cooperative approach will help get claims paid. If, however, a claim is challenged, policyholders should look to prior policies and claims, as well as internal insurance company documents, to establish the non-materiality of any alleged misrepresentation.

ABOUT THE AUTHOR

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