TRADE CREDIT INSURANCE – A Risk Management Tool in Turbulent Economic Times

BY PETER HALPRIN AND VIVIAN MICHAEL

In times of economic turbulence, are you certain you're equipped to face challenges? In this article, the authors offer their take on trade credit insurance from addressing disclosure issues to finding the right dispute resolution mechanism. Learn how trade credit insurance, with proper counsel, can be a powerful risk management tool.

A joint survey of members of the International Union of Credit Investment Insurers and the International Credit Insurance and Surety Association (ICISA) found that more claims were filed under trade credit insurance policies in 2015 and 2016 than at any time since the 2007-2008 global financial crisis. The crash in commodity prices, according to ICISA, has "put pressure on the economies of many countries dependent on these exports and in line with the high business volumes, members have reported a significant rise in claims and insolvencies". Brexit, Venezuela's economic crisis, and uncertainty about American trade policy are just a few examples of current events contributing to this trend.

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The heightened demand indicates that trade credit insurance is a vital risk management tool at present for companies engaged in global trade. It is therefore incumbent on purchasers to take steps to ensure that the policies they purchase will actually cover any losses that occur. As outlined below, that means taking special care in the application process, and also scrutinising the policy's dispute resolution provisions. Those provisions generally require that disputes be resolved through arbitration. But as we will see, not all arbitration procedures – or provisions – are alike.

A Brief Primer on Trade Credit Insurance

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. 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." Insurance companies market trade credit insurance as:

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 favourably upon funding requests, often enabling the policyholder to negotiate better financing terms.

According to ICISA, "Since the start of the global financial crisis in 2008, credit insurers have paid claims of around EUR 56 billion, compensating banks, traders and exporters for losses suffered due to defaults by buyers or other obligors, providing a stabilising function and ample support for international trade."

Getting Trade Credit Insurance Claims Paid

When disputes between trade credit policyholders and their insurance companies arise, they tend to involve insurance company allegations of non-disclosure and are often resolved behind closed doors in arbitration.

Addressing Disclosure Issues

In all lines of insurance, insurance companies sometimes raise the defense of nondisclosure to avoid paying claims, arguing "If we had known about X term, we never would have sold you this insurance policy." In other words, the failure to disclose X term was an allegedly material representation (or omission). If an insurance company can prevail on this argument, it sometimes can void a policy altogether, denying coverage for any claim under that policy. In some jurisdictions, insurance companies that prevail on a material misrepresentation defense do not even have to return the premium.

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For trade credit policyholders, maximising recovery requires a three-pronged approach: identifying potentially material facts, disclosing them in writing during underwriting, and maintaining a helpful, cooperative, open flow of information.

1. Identifying the Material Facts. Insurance companies may raise the nondisclosure defense even if a claim is otherwise valid. In some jurisdictions, an insurance company can rescind a policy that was issued in reliance upon a material misrepresentation. A misrepresentation may be a false statement or a failure to disclose where a duty to disclose exists. In many jurisdictions, the insurance company has the burden of proving that the applicant for insurance made a material misrepresentation and that the insurance company would not have issued the policy had it known the actual fact.

Policyholders and their insurance brokers should think through what elements or terms that are not being sought could be material at the outset of the policy application or renewal process. Working with a diligent broker can significantly reduce the risk of non-payment of a claim on the ground of non-disclosure. For example, some brokers use proprietary application forms that are simply appended to the application provided by the insurance company.

If the non-disclosure argument is raised, policyholders should look to past dealings with the insurance company to refute it. The insurance company's prior transactions, either with the same policyholder or with another policyholder underwriting the same risk, can help make the case that the same policy would have been issued had the disclosure been made. Internal underwriting manuals and guidelines also could confirm that the policyholder identified all of the necessary prerequisites for coverage, i.e. that the insurance company would have sold the policy in spite of the alleged misrepresentation.

2. Disclosing the Material Facts in Writing. Because trade credit insurance policies cover sophisticated transactions, applications require detailed financial information such as sales data, debts, credit exposure and payment terms for all of the parties. Policyholders should make expansive disclosures with regard to such information and work closely with co-insureds, additional insureds and any other potential partner in the transaction to make a full and complete disclosure.

3. Stay Engaged and Helpful. Throughout the application process, policyholders and their brokers should ask the insurance companies in writing if they need anything further or have additional questions.

B Resolving Disputes Through Arbitration

Trade credit insurance policies frequently contain provisions that require arbitration of coverage disputes. Arbitration has its advantages and disadvantages. Three real-world examples are illustrative.

1. Arbitration is Hard to Avoid. In one trade credit insurance dispute in the United States, the court permitted arbitration to go forward despite some seemingly contradictory dispute resolution language in the policy. The court's ruling depended in part on the fact that an executive at the policyholder's company closely read the insurance policy but made no comments on the arbitration provision. Insurance purchasers take note!

2. Arbitration Can Streamline Disputes. A policyholder was seeking resolution of four trade credit insurance claims with four different insurance companies and sought to obtain payment before the end of a fiscal year. Outside counsel was the same on both sides in all proceedings, and all of the disputes were based on one coverage issue – disclosure. Arbitration rules afforded counsel on the two sides the flexibility to agree to streamline the proceedings, resulting in expedited resolution of the key issue, and rapid resolution of all four matters.

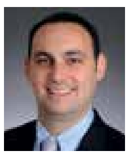
3. Arbitration Can Stall Resolution. In a matter involving *ad hoc* arbitration, which does not use an arbitral institution to oversee matters, an insurance arbitration screeched to a halt when the umpire on the arbitration panel proved unresponsive, taking the better part of a year to rule on a procedural matter.

The takeaway is that a policy's dispute resolution provision deserves scrutiny. Arbitration may save time and money but it may fail to ensure a fair procedure for the policyholder if, for example, the arbitrators can only be current or former insurance executives. Trade credit policyholders should work with counsel to develop a dispute resolution mechanism that permits both sides to have a full and fair airing of any issues.

Ensuing that policyholders **get the most out of trade credit insurance requires diligence in disclosure** as well as in finding the right dispute resolution mechanism.

Conclusion

As trade credit insurance provides the financial industry and other policyholders with balance sheet protection and mitigates risk, it can prove to be a valuable tool. Ensuring that policyholders get the most out of this tool requires diligence in disclosure as well as in finding the right dispute resolution mechanism.



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