

## **CORONAVIRUS: CONSIDERATIONS WHEN CLAIMING ON CREDIT INSURANCE**

The market for credit insurance has increased exponentially in recent years with financial institutions purchasing credit insurance for capital mitigation purposes and as a hedge against default risk. What should financial institutions do now to ensure they are able to claim on their credit insurance policies in light of growing concern that the coronavirus will lead to borrowers requesting payment holidays or, worse, becoming insolvent and defaulting on their debt?

### **INTRODUCTION**

Credit insurance or non-payment insurance policies written in recent times typically protect financial institutions against non-payment by borrowers under credit facilities (both bilateral and syndicated) and are used by lenders, not only as a protection against borrower default, but also as a credit risk mitigant for the purpose of obtaining regulatory capital relief under the EU Capital Requirements Regulation<sup>1</sup> ("CRR"), or equivalent local legislation implementing the Basel Accords. Similarly, trade credit insurance is also widely used by financial institutions to protect against loss on their trade receivable portfolios.

Right now it is widely anticipated that, even with the unprecedented economic measures announced by governments across the globe in response to the coronavirus pandemic, borrowers are likely to seek payment holidays, covenant resets and other debt restructurings, and some borrowers may become insolvent and default on their payment obligations.

Financial institutions who have credit insurance protection should review their policies now to ensure that they take adequate steps to ensure that they maintain their cover and do not take (or omit to take) any action that would result in an insurer having grounds for denying a claim. In this briefing we set out a list of practical and legal points for lenders to consider when reviewing their policies. The observations in this briefing apply to credit insurance policies governed by English law with provisions commonly included and certain points will be of equal relevance to trade credit insurance.

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<sup>1</sup> Regulation (EU) No 575/2013 of the European Parliament and of the Council of 26 June 2013 on prudential requirements for credit institutions and investment firms.

## **PRACTICAL AND LEGAL CONSIDERATIONS:**

### **Insuring clause**

Insuring clauses provide cover for losses caused by non-payment of amounts due under the insured credit agreement. However, the scope of this clause together with exclusions, conditions precedents and warranties should be considered to determine the scope of cover available. In our experience, non-payment policies do not have an exclusion for pandemics, not least because any such exclusion would be contrary to the criteria applicable for an insurance policy to qualify as a credit risk mitigant under CRR. In many instances cover may only extend to defaults of principal and not interest or other fees payable.

### **Notification**

Generally, an Insured is required to notify the Insurer within a prescribed timeframe after becoming aware of a circumstance which could result in a loss under the policy. Whilst such provisions are unlikely to be framed as a condition precedent (which if breached would entitle the Insurer to reject the claim regardless of whether any prejudice had been suffered), it is important to give timely notification, not least in order to advance the claim. Insured lenders should consider, having regard to the current situation, their assessment of the borrower's credit situation and the likelihood of an event of default occurring under the insured credit agreement, whether the circumstances warrant notification to the Insurer.

### **Proof of loss**

The legal burden is on the Insured to prove its loss. The policy will usually set out in a schedule a pro-forma proof of loss which will need to be submitted with relevant information and supporting documentation. Consideration should be given as to whether the Insured is able to share with the Insurer information received from a borrower as there may be confidentiality and legal restrictions in the underlying credit agreement. Further, many policies provide for a set time-frame within which a proof of loss has to be submitted, and a time frame for bringing proceedings if it is disputed, after which the Insurer is discharged from all liability in respect of the relevant loss - the time-frame tends to be shorter than statutory limitation periods.

### **Waiting period**

It is common for credit insurance policies to prescribe a timeframe (usually between 90-180 days) which must lapse from the date of loss before payment of a claim. Note also that some policies provide that although a claim may be made on acceleration of a credit facility, no payment will be made by the Insurer until the original due date under the insured credit agreement.

### **Consents**

Credit insurance policies often require the Insured to consult with, or seek the prior written consent of, the Insurer before agreeing any material amendment or waivers under the insured credit agreement (including any agreement to payment holidays or the acceptance of reduced amounts on scheduled repayment dates or agreeing to a rescheduling of the debt). Where this requirement is framed as a warranty, breach of it will suspend cover (indefinitely where the warranty is not capable of being remedied). Insurers when considering requests for consent from lenders should bear in mind that

the steps proposed by the lender may be influenced by guidance given by the regulator to lenders, for example, the recent "Dear CEO" letter sent by the PRA to lenders on 26th March 2020 which includes guidance on the treatment of borrowers who breach covenants in the insured credit agreement due to the coronavirus pandemic.<sup>2</sup> Further, where a credit facility is syndicated, such consent requirements need to be considered in the context of provisions relating to majority lender decisions.

### **Duty to make a fair presentation**

It should be noted that the Insured has a duty to disclose material facts and circumstances not only at the inception of the policy but at the time of any variation, including where a policy is endorsed. Thus, if a borrower asks for an amendment to the insured credit agreement, which requires an endorsement to the policy, lenders will need to ensure carefully that all material facts and circumstances relevant to the endorsement are disclosed to the Insurer at the time.

### **Warranties**

Careful attention must be paid to provisions of the credit insurance policy expressed to be warranties as these must be complied with by the Insured, otherwise cover will be suspended and the Insurer will have a basis to deny a claim. Certain warranties, such as the requirement for the Insured to maintain a minimum retained uninsured percentage of the credit risk, are continuing warranties (and need to be kept in mind if the Insured is considering selling down its holding in the secondary market as part of its risk mitigation strategy).

### **Payment of premium**

Credit insurance policies, other than where the Insured has been fraudulent in making a claim, will typically only entitle an Insurer to cancel in the event that there has been non-payment of premium. So, it is important for the Insured to continue paying premium on time (although most policies will afford some grace period to pay overdue premium).

### **Compliance with insured credit agreement obligations**

In order to maintain cover, Insured lenders must comply with their obligations under the insured credit agreement. This includes funding advances where it is under an obligation to fund.

### **Duty to minimise and mitigate loss**

The Insured will be required to take reasonable steps to avoid loss and minimise loss. An Insured may be expected to take steps that it would have taken had the exposure been uninsured, including in certain policies initiating legal proceedings against a defaulting borrower. Whilst completing these steps (particularly, where legal or other proceedings have been commenced) should not be pre-condition to payment under a policy, to the extent that an Insurer can show that the failure to take reasonable steps has prejudiced its rights, it may be able to recover for any loss that it has suffered. It is feasible that Insurers could seek to argue that where a lender has governmental support available to it in the current climate (e.g. the ability to obtain a state

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<sup>2</sup> Letter from Sam Woods to Chief Executive Officers of UK Banks "Covid-19: IFRS, capital requirements and loan covenants"

guarantee of the insured debt), that the Insurer should take advantage of such governmental support to mitigate its loss.

### **Subrogation**

Once a claim is paid, the Insurer will "step into the shoes" of the Insured and be able to make recoveries from the obligors under the credit documentation. There will be several considerations: is the Insured required to assign rights to the Insurer or is it required to take action on behalf of the Insurer, and where the Insured has uninsured loss, will it be required to agree a strategy with the Insurer before taking action in relation to its uninsured holding?

### **Recoveries**

Where the Insured or the Insurer make recoveries, the policy will set out how such recoveries are to be distributed, including specific rules on how the costs of recovery are to be shared between the Insurer and the Insured.

### **Confidentiality**

The parties to the credit insurance must comply with the confidentiality provisions in the policy which will generally include a general prohibition on disclosing the existence of the policy and include a prohibition on disclosing information received or using it for purposes unrelated to the policy.

### **Disputes**

If there is a dispute between the Insured and Insurer, the policy will set out the mechanism for dispute resolution (commonly arbitration).

Our "Coronavirus: considerations when claiming on Credit Insurance" briefing and other Coronavirus (Covid-19) materials can be found [here](#).

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