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TRADE CREDIT INSURANCE BACKSTOP FOR CORONAVIRUS-RELATED RISK

The UK trade credit insurance ("**TCI**") guarantee scheme ("**Scheme**") was announced in a press release by the government on 4 June 2020. This initiative is unprecedented in the UK and follows extensive engagement with industry stakeholders.

TCI policies facilitate trade by protecting businesses from the risk of non-payment by their customers arising from insolvency and/or protracted default. The insurance provides access to working capital facilities in the intercompany trade credit market and plays a key role in maintaining supply chains. As of April 2020, the UK's trade credit insurers covered £171 billion of business activity, involving 13,000 suppliers and 650,000 buyers according to the ABI.

TCI policies do not commonly exclude pandemic-specific risks. The major players in the market (including Euler Hermes, Coface and Atradius) are therefore facing major challenges as a result of the increased risk of payment defaults and insolvencies due to the coronavirus. The unprecedented number of expected claims, plus difficulties in assessing the solvency and risk profile of firms (especially if they are unrated) have prompted insurers such as Euler Hermes to announce they may withdraw TCI cover in certain countries or market segments which are being affected by the pandemic, such as the aviation, travel and construction sectors.

By guaranteeing claims payments, the overriding objective of the Scheme is to encourage participating insurers to show greater flexibility towards TCI policyholders, thereby minimising their liquidity issues and reducing the number of commercial insolvencies. There are various ways insurers can adopt a pragmatic approach – for example by:

(a) reducing premiums or delaying premium payment dates;

(b) extending timeframes for claims notification and filling;

(c) guaranteeing renewals on similar terms; and

(d) waiving policy termination rights, that would typically entitle insurers to cancel coverage where certain policy terms are breached, such as warranties and premium payment obligations.

The Scheme is also intended to create a level playing field in the TCI market, given similar state guarantees have been announced across the EU and in Canada.

The Scheme will:

(a) be structured as a temporary quota share insurance for UK-established insurers, covering domestic and overseas trade with payment terms of up to two years;

(b) reinsure 90% of insurance claims up to an aggregate cap of £3 billion (with full coverage on claims between £3 billion and £10billion); and

(c) be available retroactively from 1 April to 31 December 2020, with potential for extension.

Insurers participating in the Scheme will be expected to provide certain “undertakings” as to the conduct of their guaranteed TCI business. These include relinquishing profits by passing on policyholder premiums and freezing dividend and bonus payments.

The are some key questions. Regarding the Scheme perimeter, it is unclear whether the guarantee will backstop insurers with other partial reinsurance already in place – for example, on an excess of loss basis.

Further details are also needed on the scope and nature of the undertakings that will apply to insurers who participate. For example – will a coverage condition apply? This was introduced in Belgium’s state guarantee program, which requires participating insurers to maintain credit limits historically applied in the twelve months preceding March 2020. This is accompanied by corollary reporting obligations to monitor any changes to each credit insurer’s commitment.

Finally, it is unclear what transitional measures will be implemented to phase insurers out of the Scheme. These questions will also need to be addressed in the context of other guarantee schemes that are being looked at to assist the insurance industry (such as the Pool Re model adopted in response to terrorism risk).

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