Be prepared

Start reviewing your contractual arrangements with distributors and claims supply chain suppliers now. Don’t wait until an insolvency occurs to find out that you have no written contract, or a written contract with insufficient protections. By then, it will be too late.

We recently carried out a survey of in-house counsel working for top UK insurers. 79% of those who responded were unable to say with confidence that their contractual arrangements protected their companies effectively from the risk of a distributor or supplier becoming insolvent.

Areas to focus on

Distribution agreements

• Make sure the agreement provides that premiums received by the distributor (or its sub-agents) will be held on trust on your behalf and monitor this.

• If the distributor sells your insurance products through sub-agents, consider requiring the distributor to accept all, or part, of the risk of its sub-agent becoming insolvent.

• If you pay an advance commission or make a financial contribution to marketing, carefully review the structure of such payments. For instance, you may want to spread the payment of advance commission over the period of the agreement or structure the marketing contribution so that you are only required to pay when marketing costs are actually incurred.

• If you pay commission to an independent financial adviser (IFA) on an indemnity basis and the IFA becomes insolvent, it is unlikely you will be able to claw back in full any commission due to you if the IFA’s customers cancel or move their policies during the earnings period. So you may want to think about paying commission on an “as earned” basis rather than an indemnity basis.

• If you provide a loan to a distributor, consider securing repayment of the loan against the distributor’s assets. This may mean you will need to enter into releases or deeds of priority with other creditors who may already have security over the same assets.

Claims supply chain agreements

• Review the payment terms. Make sure payment is only due from you on delivery of the goods, or on completion of the services.

• Check the agreement clearly sets out the grounds and consequences of termination and that it provides you with adequate protection. For example, you may want the right to require the insolvent supplier to pass on claims to any supplier appointed by you as its replacement.

• Review your supplier’s business continuity plan to find out whether it adequately addresses the risk of any of its own suppliers becoming insolvent.

Other ways to mitigate the effects of an insolvency

• Even a properly drafted contract may be of little use if the other party is not complying with its terms. Regularly checking that your distributors and claims suppliers are meeting their obligations could identify a problem before it is too late. In particular, make sure your distributors are fulfilling requirements to hold premium income or claims funds on trust.

continued overleaf
• Avoid over-reliance on a single supplier for a particular product or service. If you appoint more than one supplier, you may find it easier to divert work if one of them becomes insolvent.

• Look out for warning signs. Downgrading by rating agencies, non-performance of key performance indicators or misapplication of selection criteria may all be early signs that a distributor is facing financial difficulties.

• When reviewing your claims supply chains, think about the pros and cons of offering cash settlements instead of arranging replacements. Supplying replacement goods can be a more cost effective option, but it can also expose you to the risk of the supplier of those replacements becoming insolvent.

How we can help

Our team of specialist lawyers has considerable experience advising clients on general and long-term insurance distribution and supply chain agreements and on any insolvency issues that might arise.

We can carry out “health checks” of your distribution and claims supply chain agreements to make sure that they give you the best possible protection in the event of a distributor or supplier’s insolvency.

We can advise you on the effect an insolvency of a distributor or supplier might have on your business and what practical steps you can take to minimise its impact. And we can give you bespoke training on new contract terms and how to deal with distributors and suppliers in financial difficulties.

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This note does not constitute legal advice. Specific legal advice should be taken before acting on any of the topics covered.