ALLEN & OVERY

Covid-19 coronavirus: *key legal considerations for bancassurance arrangements*

The Covid-19 pandemic has had a significant impact on all economic and business activity globally. Standing today in the eye of the storm, the ultimate consequences of the crisis remain unclear, but banks and insurers have begun to take stock of the potential risks and liabilities that they may face. Among these, bancassurance arrangements are among the more valuable commercial contracts that these financial institutions will need to scrutinise in light of current circumstances. We have summarised below certain key legal and contractual issues in bancassurance arrangements that may arise from Covid-19.

Sector impact

The expectation is, following the trends seen after SARS, that the crisis will impact insurance distribution in three waves:

– **Firstly** – decline in product demand, sales and increase in policy cancellations across all business lines due to the financial downturn and a reduction in customer resources and access;

– **Secondly** – spike in customer claims in areas such as health, life, income protection, business interruption, event cancellation/travel insurance due to the impact of the crisis and the associated lockdowns (set off against lower claims for ordinary course events, such as PA or motor insurance claims, due to a lack of customer activity); and

– **Thirdly** – subsequent increase in demand for specific types of health and life products, providing specific Covid-19 protection or more general coverage.

As a result, when considering their contractual obligations and their distribution arrangements, banks and insurers should prepare themselves for these waves in the short to medium term, as well as refocusing on digital distribution as a means to pick up ordinary course business.

Force majeure/frustration

The nature of the current interruption to business activity has caused many contracting parties to consider the application of the doctrine of frustration (or its equivalents, such as "impossibility" and "unforeseen circumstances") and force majeure clauses in a range of commercial contracts. These legal concepts are distinct, and their applications will be circumstance-based, but our expectation is that they will have a limited effect on bancassurance arrangements (notwithstanding the current situation):

– The doctrine of frustration under English law entitles parties to cancel a contract where an event or circumstance so changes the nature of that contract and the ability of the parties to perform under it that it would be unjust not to cancel it. Establishing frustration is correspondingly a high bar and historically has been successfully invoked in only a few limited circumstances.

– Force majeure (FM) is different from frustration in that it describes a contractual provision either specifically included or implied by law that suspends parties' obligations without breach in circumstances where the parties cannot perform some or all of the contract due to a specifically defined event or circumstance. Where an FM clause is provided in a contract, it becomes even harder to make a case for frustration given that the FM clause establishes the parties' intentions where such frustrating event occurs.

– Most bancassurance arrangements will include FM clauses, which in most cases may suspend performance obligations and product exclusivity if the force majeure applies to a product and/or, if the force majeure continues for a period of time, may allow termination of the contract.

– While the current lockdown situations in many jurisdictions may restrict or hinder parties from satisfying certain of their obligations under a bancassurance arrangement (eg physical product distribution through bank channels, insurer access to bank branches, provision of training and certain other obligations), subject to the wording of the relevant FM clause, from a practical perspective most distribution arrangements may still be performed, just with more restrictions (eg banks remain open in certain jurisdictions, but with limited opening hours) or with narrower distribution channels (eg digital channels). Accordingly, broadly speaking we see limited scope for widespread exercise by parties of FM clauses in bancassurance arrangements.

Performance obligations

The clearest short term issues arising from the current financial downturn will be the underperformance of bancassurance arrangements. The impacts, subject to the terms of the relevant contract, may be as follows:

– Banks will not be able to meet sales targets or premium milestones as customer interest wanes, cancellations increase and persistency drops off, leading to non-payment of performance linked bonuses (or other deferred payments) and reductions in certain other allowances.

– Insurers may have the ability to force extensions of the terms of distribution contracts or exercise clawbacks of upfront payments to compensate them for non-performance during this period.

– In general it is unusual in bancassurance arrangements to have contractual adjustments to "normalise" sales targets and milestones for market events, but there may be obligations or opportunities for the parties to discuss and revise their business plans and the financial package for the distribution arrangements where there is a market shift.

Products

Given the likelihood of a short term decline in sales, to be followed by an uptick in consumer demand for health and life products, banks and insurers should begin to consider the following:

– What level of control does the bank or the insurer have to manufacture or request new Covid-19-specific products (health, life or associated risks) or to make amendments to existing products to extend coverage to Covid-19 risk?

– Where a bank has two exclusive life and non-life insurance partners, what exclusivity does the life or non-life insurer have in respect of any "overlapping" health Covid-19 products that can be written under both licences?

– How will the bank address any of its exclusivity obligations where a government mandates banks to sell certain products (eg income protection, health and PA) manufactured by a sovereign entity, government-backed insurer or where exclusivity in respect of such products is legally restricted?

Distribution networks

In the immediate term, insurers will want to ensure that under their existing bancassurance arrangements they are entitled to distribute products through a bank's digital channels while physical distribution is restricted. Going forward, IT integration and functionality should be refined (if not already in place) and a greater portion of the marketing budget should be focused on these channels. One of the expectations is that the current crisis may lead to greater reliance on digital distribution more generally, so investment now may prove to be beneficial in the long term.

Regulatory engagement

Banks and insurers will need to consider how they can manage regulators, where approvals may be required for new products, business plans, amendments to the distribution agreement and licence renewals. Where regulators are not functioning, parties may need to be realistic about their respective performance obligations vis-à-vis regulators and, for existing bancassurance arrangements, carefully consider any regulatory timelines (eg for product approvals) as parties may need to agree to extend these – this can be of particular importance to insurers if the inability to meet these timelines results in a loss of exclusivity.

Solvency issues

Banks and insurers should pay attention to any requirements under their bancassurance arrangements with respect to credit ratings, capital requirements and/or solvency that need to be satisfied (eg in connection with termination rights, compliance with law or product exclusivity) ahead of a potential downturn. These may also be indicators of poor financial health of a counterparty, potentially leading to termination of the distribution arrangements on account of the insolvency of a party.

Organic and inorganic growth and contraction

The likelihood of a distressed market in the medium term could have a profound effect on the respective size and composition of bank and insurer counterparties:

– This could lead to opportunistic or mandated acquisitions (eg government-mandated consolidations in the banking sector) that could increase a bank's size and customer base, while bringing across conflicting exclusive bancassurance arrangements. Parties may need to consider the consequences of inorganic growth under their distribution arrangements and their respective rights.

– Equally, contraction of a bank or an insurer could be a consequence of the downturn, either due to poor performance or strategic sales of parts of their businesses. Termination rights or breaches of other obligations may arise from shrinkage of the parties' respective businesses or their ability to perform the contract.

Customer communications and management

Banks and insurers will need to consider customer communications, their contractual obligations to customers and to balance the reputational impact of their actions against the profitability of the business. Key issues include:

– Should customers be permitted to delay policy payments, or does new legislation entitle them to delay making such payments?
– Should coverage be extended to cover Covid-19 risks, even if excluded, from a reputational point of view?
– Should claims relating to Covid-19 be covered where excluded by the relevant policy, or where a government has promised to underwrite the relevant customer's healthcare?
– Should insurers make payments for claims arising from secondary risks (eg travel insurance pay-outs for cancelled travel etc)?

Banks and insurers may have differing views on each of these issues depending on who maintains the customer relationship and resolution of these views may be subject to the terms of the distribution agreement.

Performance obligations and logistics

There will be a number of obligations on both parties to a bancassurance arrangement that will be restricted or hindered by the Covid-19 situation. Subject to the terms of the relevant contract, these may give either party the opportunity to call a breach or even to seek a termination. Parties should enter into a dialogue to the extent that they can find reasonable solutions or waivers to certain of these issues. A non-exhaustive list of certain of these items includes:

– **Service levels and other BAU obligations** – A reduction in operational capacity at both banks and insurers will have the consequence of impacting service level performance (including distribution, production of marketing materials, customer sales, claims management and processing, among others) and the ability of the parties to satisfy their own practical obligations under the contract. The impact of these technical breaches will need to be considered, including if are they protected by an FM clause or not.
– **Time periods** – There is a likelihood that all of the time periods and processes under the distribution arrangement may become difficult to achieve and unrealistic in the current environment. Parties should note in case there is a "time of the essence" clause in the agreement that could entitle the non-breaching party to be able to terminate.
– **Governance** – If the relevant members of distribution committees and sub-committees are working from home, is it permitted for them to operate through conference or video calls?
– **Sale logistics** – Can certain products (eg unit-linked life products) be sold by bank or insurer staff if there is no physical face-to-face interview and, if so, is a video call a permitted replacement for this requirement and are electronic signatures valid?
– **Employee management** – What sales incentives are due to employees and should or can these be deferred given the current environment?
– **Execution and logistics** – Where any amendments or notices under the agreement are required, are electronic notices and signatures permitted?

Customer data

Banks and insurers should consider their respective rights to customer data, and particularly any such data (whether customer or policyholder data) that identifies a person as having, or having had, Covid-19. Some governments have been talking about medical passports as a consequence of the crisis and the confidentiality of this kind of personal data could prove to be critical to such customers.

Term and termination

As noted above, there are a variety of circumstances that could lead to potential extensions or terminations of bancassurance arrangements. Where this is an attractive option, both counterparts will need to consider whether statutory forbearance provisions will restrict such termination.

Resolution and renegotiation

Given the above, parties will need to consider respectively the scope and importance of their bancassurance arrangements, the strengths of their mutual relationships and whether there is appropriate leverage for the parties to waive or renegotiate any aspect of their arrangements impacted by the above. On the contrary, some parties may view the current situation as an opportunity to break the partnership off and negotiate a new deal. In either case, it would be prudent in the short term for parties to establish a dialogue and refocus the steering committee towards crisis management as means to manage the disruption caused by the Covid-19 situation, and thereafter to potentially resolve certain of the issues highlighted above.

Disputes

Where banks and insurers enter into a dispute under a bancassurance agreement arising from a Covid-19 related issue, they will need to bear in mind that service of notice, undertaking mediation/litigation/arbitration and enforcement of claims will prove difficult in the current environment. The slow pace of court and tribunal-based disputes processes may force parties to continue to mutually perform their arrangements and to rely more on negotiation and settlement where any breaches arise.

Conclusion

Given the current flux in the market, the uncertainty of what the future holds and the fact that any of the issues highlighted above will be circumstance-specific, the commentary above is designed for issue spotting and thought provocation. If the crisis has the logical three-stage business impact indicated above, then the impact on bancassurance distribution may be relatively modest in the long term, with a short term reduction in sales set off by a subsequent growth. However, the more significant and long-lasting impact may be the acceleration of the existing movement to digital distribution and sales platforms.

We continue to advise banks and insurers on their bancassurance arrangements and remain happy to discuss any specific issues that you may have.

Your key contacts

If you have any questions on the issues raised above or would like to have a more detailed discussion, please do not hesitate to contact us:

Chris Moore
Managing Partner, Singapore
Tel +65 6671 6064
christopher.moore@allenovery.com

James Mythen
Partner, Singapore
Tel +65 6671 6077
james.mythen@allenovery.com

Sugianto Osman
Partner, Jakarta
Tel +62 21 2995 1728
sugianto.osman@allenovery.com

Tina LeDinh
Partner, Ho Chi Minh City
Tel +84 28 6288 4948
tina.ledinh@allenovery.com

Kenna Safrudin
Counsel, Jakarta
Tel +62 21 29951719
kenna.safrudin@allenovery.com

Chris Burkett
Counsel, Bangkok
Tel +66 2 2637607
chris.burkett@allenovery.com

Ayesha Thapar
Senior Associate, Singapore
Tel +65 6671 6056
ayesha.thapar@allenovery.com

Christine Fong
Associate, Singapore
Tel +65 6671 6018
christine.fong@allenovery.com