

Liability insurances

M96: 2018–19 edition

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Please note the following update to your copy of the **M96** 2018–19 study text:

Brexit Contract Continuity Clause and contingency plans

The forthcoming withdrawal of the United Kingdom (UK) from the European Union (EU) (Brexit) creates uncertainty regarding UK insurers' ability to continue to perform insurance contracts which cover insureds domiciled in the EU/European Economic Area (EEA)². At present, as the UK is an EU Member State, UK insurers can insure risks domiciled in the EU/EEA under the **Services Directive**. After Brexit, this Directive will no longer apply in the UK, and UK insurers could be unable to insure risks in the EU/EEA if no other agreement is reached. The consequences of such a withdrawal might be that those insurers currently providing insurance in the EU/EEA on a Freedom of Services basis could, after Brexit, be deemed to be carrying out a regulated activity without a licence. As at the time of writing, Brexit is under a year away, insurance contracts entered before it with a typical duration of 12 months will still be in force after it. Insurers and their clients could, therefore, find themselves in the position that such a contract can no longer be performed after Brexit. We call this scenario a 'Brexit event'.

Insurers are making contingency plans to ensure continuity to contracts entered into before Brexit, in case the UK leaves the EU without suitable transitional arrangements, and if no agreement has been reached to permit UK insurers to perform insurance contracts involving EU/EEA-domiciled insureds. The solution proposed by insurers is to place insurance contracts that include cover for an EU/EEA insured with both a UK-domiciled insurer and another insurer based in the EU which will act as a contingent insurer providing cover, paying claims and performing any other policy obligations, if a Brexit event occurs. Almost invariably the contingent EU insurer will belong to the same group as the UK insurer.

The continuity clause would not apply in the case of a Brexit agreement that allows the UK insurer to continue to perform their obligations under a contract without being exposed to any prohibition or sanction.

The UK insurer, the EU insurer and the insured would all be contractual parties, so there is no transfer of risk from the UK insurer to the EU insurer at the time of a Brexit event, as both insurers would already be parties to the contract. This would give the insured confidence that, should a Brexit event occur, the policy would continue on the same terms with the EU insurer and that any premium received by the UK insurer would still apply.

There are other safeguards for the insured in case a Brexit event has unexpected elements. For example, an insurance contract will be terminated where neither the UK nor the EU insurer is permitted to perform the contract. This will require notice of cancellation to be given to the insured after a Brexit event has triggered the clause, and the premium paid would be returned on a *pro rata temporis* basis.

The insured is also granted a right to cancel the remaining part of the contract if the UK and EU insurers cannot together perform the whole contract. This is to give the insured the opportunity to change insurers if they cannot perform a contract in its entirety. For example, if the EU insurer is not licensed to insure a risk on a Freedom of Services or Freedom of Establishment basis in one or more EU/EEA Member States where the insured had subsidiaries covered by the policy when the Brexit event occurred. In this case, the insured would also be entitled to a *pro rata temporis* return premium.

The Brexit contract continuity clause is also drafted to operate if insurance contracts underwritten on a Freedom of Establishment basis cannot be performed after a Brexit event. This would be the case where the UK Branch of an EU/EEA insurer was no longer permitted to undertake insurance business in the UK, so the contract would be performed by their designated EU insurer, both in respect of the UK and the EU/EEA insured, if permissible by law at the time after the Brexit event.



Freedom of Services (FoS) and Freedom of Establishment (FoE)

The legal bases of Freedom of Services (FoS) and Freedom of Establishment (FoE) are Articles 26 (internal market), 49 to 55 (establishment) and 56 to 62 (services) of the Treaty on the Functioning of the European Union (TFEU), also known as the Treaty of Rome of 1957.

Self-employed persons and professionals or legal persons within the meaning of Article 54 TFEU who are legally operating in one Member State may: (i) carry on an economic activity in a stable and continuous way in another Member State (freedom of establishment: Article 49 TFEU); or (ii) offer and provide their services in other Member States on a temporary basis while remaining in their country of origin (freedom to provide services: Article 56 TFEU).

The Agreement on the EEA, which came into force on 1 January 1994, brings together the EU Member States and three of the four European Free Trade Association (EFTA) States – Iceland, Liechtenstein and Norway – into the EEA to create a single market, referred to as the ‘Internal Market’. Switzerland, the other Member of EFTA, is not a Member of the EEA. The EEA Agreement provides for the inclusion of EU legislation and also the freedom to provide services throughout the EEA States.

Freedom of Services (FOS) is the provision of insurance in one EU/EEA Member State to an insured domiciled in another EU/EEA Member State. Insurers established and authorised in one EEA Member State can conduct business, i.e. cover risks located in other EEA Member States, under the prudential supervision of their Home State regulator, without requiring separate authorisation in other Host States. Freedom of Services (FoS) is regulated by the **Third Non-Life Insurance Directive**.

Freedom of Establishment (FOE) involves the establishment of a local branch office in a Member State by an insurance undertaking from another EEA Member State. The **Third Non-Life Insurance Directive** introduced a single authorisation system where an insurance undertaking in one EU Member State may open branches or carry on business in another State under the supervision of its Home State regulatory authority.

To undertake any class of business in another EEA State the insurer must:

- be licensed to undertake that class of insurance in its Home State;
- notify the Home State regulatory body of its intention to carry on business in another Member State on an FoE or FoS basis; and
- comply with any conditions on which, for reasons of the ‘General Good Provisions’, such business must be conducted in the non-Home State (usually referred to as the Host State). These generally apply to consumer insurance transactions rather than commercial contracts.

1. Credit to the International Underwriting Association of London (IUA) which issued the Brexit Contract Continuity Clause and explanatory notes
2. See box below
3. Credit to the IUA for its paper *Freedom of Services and General Liability Insurance*, June 2016