

## Consequences of Brexit on existing contracts



### Executive summary

Currently, EU/EEA (re)insurers can provide contracts to customers in the UK, and UK (re)insurers can provide contracts to customers in the EU/EEA, through passporting — ie across borders (freedom of services) and through local branches (freedom of establishment). After Brexit, passporting rights between the EU/EEA and the UK will cease. EU/EEA branches of UK-based (re)insurers will become third-country branches and vice versa.

The TF50 [position paper](#) “Essential principles on citizens’ rights” says that the Withdrawal Agreement should protect the rights of EU27 citizens, UK nationals and their family members who, at the date of entry into force of the Withdrawal Agreement, have enjoyed rights relating to free movement under Union law, as well as rights that are in the process of being obtained and the rights the enjoyment of which will occur at a later date, including, for example, pension rights. EU and UK citizens have rights under those contracts, and their ability to exercise those rights depends on (re)insurers’ ability to service those contracts.

EU/EEA (re)insurers impacted by Brexit have plans in place, including contingency plans to adapt to the post-Brexit scenario. The transfer of portfolios may be an option for many types of business, even though it is a very costly (for both businesses and consumers), uncertain, difficult and time-consuming process. However, given the large number of transfers needed and the necessity to involve courts, supervisors and customers, it is very clear that it may not be enough time left for all transfers to be completed by March 2019. Therefore a transition period is required to allow time for Brexit plans to be completed.

In addition, EU/EEA (re)insurers have identified that, in specific cases, “grandfathering” is also needed for some type of businesses to uphold customers’ rights, ensure continuity and reduce uncertainty. This is the case for profit sharing and pan-European portfolios, where the assets and liabilities relating to EU27 contracts cannot be separated from those relating to UK contracts. Grandfathering mechanisms should also be considered where solutions might be possible but costs or other impact on citizens would be disproportionate. The grandfathering should take into account the continuity of the supervisory standards, as these standards currently exist in the European regulation. Given the whole range of possible actions to prepare for Brexit, grandfathering would allow policyholders to preserve their rights and interest in the best possible way.

The Withdrawal Agreement should focus, as a matter of priority, on protecting citizens’ rights under (re)insurance and pensions contracts entered into force before Brexit by passporting. For this reason, **we highlight the need for a grandfathering arrangement for current long-term (re)insurance contracts (non-life and life insurance and pensions) when a transfer of portfolio is not possible or is excessively costly for consumers.** Moreover, as part of the overarching standstill agreement on a transitional measure, a transitional arrangement should be concluded as soon as possible to provide firms and their customers with certainty and the ability to make the necessary preparations to adapt to the post-Brexit scenario.

# 1

## What are existing contracts?

Existing contracts issued by (re)insurance companies are contracts that meet the following conditions:

- Contracts concluded before the date of entry into force of the Withdrawal Agreement (or the date at which the Treaties no longer apply to the UK, if different) which give rise to obligations for either contractual party after the UK is no longer an EU member.
- Contracts issued either:
  - by a British (re)insurer through passporting to a customer residing in another EU/EEA country or who was residing in the UK at the time of sale but later moved to another EU/EEA country, and to corporate customers established in another EU/EEA country; or
  - by an EU/EAA (re)insurer through passporting to a UK-based customer or someone who later moves to the UK and to corporate customers established in the UK.

Examples of such contracts include:

- Multi-year, long-term, life insurance and pension contracts
- Contracts are taken out by citizens before Brexit are intended to collect premiums and/or provide benefits possibly decades in the future. In some cases, the contracts have a maturity date; in others, the end date is determined by the policyholder or will only occur on the death of those covered. In some cases, such “paid-up” policies mean no premiums are being collected but they still provide benefits in the form of payments or risk cover; in other cases, premiums are still being collected.
- Multi-year, general insurance contracts, such as some types of commercial package policies
- Businesses may take these policies out to give themselves longer-term certainty and they may be in force when the UK leaves the EU.
- Passporting insurance contracts that have expired at the date that the UK leaves the EU but where a claim has been reported but not yet settled, or where there can be claims in the future relating to events that occurred before the contract expired
- For example, liability policies can give rise to long-tail claims years or even decades after the policy has expired. Policies covering asbestos-related claims are a well known example.

# 2

## What do the EU/EEA passporting rights allow?

Under the EU/EEA framework, passporting rights allow EU-based (re)insurers to:

- issue contracts cross-border and/or through branches;
- service contracts sold to customers in the EU/EEA who move, later on, to another EU/EEA country.

Contracts issued on the basis of passporting are subject to prudential supervision by the home member state and conduct of business supervision by the host member state. In addition, depending on the national law under which a policy has been issued, the policy may be protected by different compensation measures in the home member state of the contract’s scheme.

# 3

## How does Brexit affect customers of existing contracts?

(Re)insurers that do business on a passporting basis between the UK and the EU/EEA and try to continue to service existing contracts after Brexit — for example by paying claims — would no longer have authorisation to do so and would breach national law in those host countries where a license is required. They could face high penalties, possible sanctions or criminal persecution under the law of host countries, regardless of the fact that the contracts between the (re)insurers and the customers are still valid. In other words, without portfolio transfers or grandfathering, (re)insurance firms would have to break the law in order to fulfil their contractual obligations.

In this situation, customers would not be able to:

- claim for risks covered by their contracts
- prevent paid losses from being treated as income in their country of residence and taxed accordingly
- pay premiums that would allow them to continue to contribute to their policies (eg pensions)
- access specific compensation measures foreseen in the home member states of their contracts

Since insurers that have appointed a legal representative under Article 145 or 152 of the Solvency II Directive are required to maintain a legal representative in the country concerned until the relevant national competent authority is satisfied that the business has been fully run off, without transfer or grandfathering consumers will not be able to bring legal action in national courts against a lawfully appointed representative of the insurer. Additionally, the payment processes between insurers and reinsurers under existing contracts might be affected.

While complete and very detailed data is difficult to obtain, analysis so far indicates that there are many millions of citizens who would be impacted and who would, therefore, benefit from appropriate solutions. For example, the Bank of England in its November Financial Stability Report indicated that six million UK policyholders and 30 million EEA policyholders are affected by the continuity of existing cross-border insurance contracts. A survey by Insurance Europe of 24 companies in the EU/EEA indicates that up to 8.6 million contracts in the EU and 8.8 million policies in the UK are impacted by (re)insurance cross-border business.

## 4 When is grandfathering the only solution for existing contracts?

Grandfathering existing contracts would offer a permanent solution to ensure that customers can continue to benefit from the contracts they have lawfully entered into until those contracts run off, possibly decades after Brexit. Grandfathering would protect customers from adverse consequences as a result of Brexit and prevent as far as possible consumer detriment and severe disruptions to customers' personal situations, such as their financial planning for retirement.

There are certain cases when grandfathering is the only solution, such as:

- Profit sharing: Contracts which relate to assets and liabilities that cannot be separated into UK and EU27 components. This would most likely lead to a high level of risk in their transfer, and a high cost to the consumer.
- Pan-European contracts: For example, directors' and officers' liability, which can be written on a pan-European basis. Here, it is not possible to split the business into UK and EU27 components.

Other potential options would not protect customers as much as grandfathering because:

- The transfer of individual contracts or books of policies to entities in another jurisdiction can be complex, lengthy and may require approval by courts/supervisory authorities and/or customers. National competent authorities reviewing transfers would face a very high workload and would probably not be in a position to authorise such transfers in time for Brexit. For instance, currently it takes the UK Prudential Regulation Authority between 12 and 18 months to approve new entities. In addition, transfers of insurance portfolios from UK (re)insurers to their new EU/EEA entities (and vice versa) would become unlawful after Brexit, unless the receiving entity had already been granted authorisation to conduct business in the relevant member state. Additionally, some types of policies do not exist in some countries and national competent authorities have no experience in supervising them. In particular, life insurance and pension contracts relate to assets that could not be untangled without high costs for customers.
- Transitional measures bridging the gap between the moment the UK exits the EU and the future EU-UK relationship coming into force are important. However, in particular for life insurance contracts, they will not resolve the problem of servicing contracts written under passporting. A transitional period is likely to be for a maximum period of 2/3 years, whereas contractual obligations under passported contracts could run for decades after Brexit. Furthermore, they require that the future relationship is agreed and precisely defined.

A transitional period would also not address the problem of being able to continue to fulfil contractual promises made to EU/EEA citizens who move to the UK, and UK citizens who move to the EU/EEA either pre- or post-Brexit.

We recommend that the UK and the EU agree on an appropriate transitional arrangement to bring legal certainty and more time so that there is sufficient time to re-organise businesses, set up branches and subsidiaries and transfer policies. In addition, grandfathering of certain existing (re)insurance contracts as part of the Article 50 negotiations under the Citizens' Rights chapter is needed.

A comprehensive approach to this issue must take reinsurance contracts and retrocession into account. Reinsurance enables insurers to reduce their underwriting risks, allowing them to strengthen their solvency, expand their capacity to absorb different types of customer risks and to reduce the volatility of their earnings, enabling them to offer lower prices to their customers. Especially in respect of life and pensions, reinsurance contracts run for decades and a permanent solution to ensure service continuation until their termination has to be found. It is therefore absolutely necessary that grandfathering provisions apply to reinsurance contracts, in order to avoid cliff-edge scenarios for customers.

Grandfathering would mean:

- Recognition that the rights and obligations of the parties to (re)insurance contracts written lawfully under passporting continue.
- (Re)insurance contracts in force at the date on which the Treaties cease to apply to the UK would continue to be in force until they expire in accordance with contractual provisions.
- Legal obstacles to the ability of a party to a (re)insurance contract to enforce a right or discharge a responsibility under the contract would not apply.
- (Re)insurers that have appointed a legal representative under Article 145 or 152 of the Solvency II Directive would maintain a legal representative in the country concerned, until the relevant national competent authority is satisfied that the business has been fully completed.
- Regulatory responsibility for contracts should remain as it is at present, ie prudential regulation would remain a home state responsibility and conduct regulation a host state responsibility. Supervisory liaison could be ensured by establishing an EU27/UK committee, possibly under the auspices of EIOPA.
- Special provisions would be needed for contracts between the UK and EEA member states that are not EU members.

The European Council's negotiating directives mandate the Commission to negotiate an Agreement that ensures any goods placed on the market before the withdrawal date will continue to be made available after the withdrawal date (paragraph 31). It is important that services are given similar consideration as soon as possible. We note the intention for services be covered by a subsequent set of negotiating directives: we would reiterate that time is of the essence and insurers and customers need certainty as soon as possible.

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