Information Briefing
October 2020

INADVERTENT FREEDOM TO PROVIDE SERVICES OPERATIONS

1. Freedom to provide services in the insurance market

The Treaty on the Functioning of the European Union, in defining the concept of freedom to provide services ("**FOS**") in Article 56, focuses on the service provider, not the recipient of the services, by stating that "*restrictions on freedom to provide services within the Union shall be prohibited in respect of nationals of Member States who are established in a Member State other than that of the person for whom the services are intended".* This is a correct approach to the issue in a European Union characterised by the free movement of persons and capital, at least before the worrying times of COVID-19, as it is easier to regulate the issue from the point of view of the service provider, which is more static, than from that of the numerous recipients/clients, who can change residence more than once and with relative frequency.

This idea was correctly transferred to the Insurance Coordination Directives, which were already in their third generation in 1992, and in a world which was totally different from that which exists today (with at most postal and vocal communications, not digital, and certainly not with the degree of sophistication experienced today), aimed for the service provider to receive "*a single official authorization issued by the competent authorities of the Member State in which an insurance undertaking has its head office; whereas such authorization enables an undertaking to carry on business throughout the Community, under the right of establishment or the freedom to provide services*" (See Recital 6 of the Third Directives on the Coordination of non-life insurance and of life assurance, as set out in their respective Article 7, "*authorization shall be valid for the entire Community*").

In other words, the Community system, or, to use current terminology, the Union, was based on a single communication, which converted the service insurer-provider into an entity which operates throughout the European Union as a whole, not only in its own Member State or in one or more other Member States.

2. Practical developments and issues that have arisen

However, the system was adulterated from the outset by virtually all insurance regulators, for the sake of prudential market control, opting for communications made to the supervisory authority of the home Member State to apply to operate under FOS identifying the State or States where such an operation was to be carried out with precision. This was the case in Spain, by means of a decision -which is no longer available from the website of the Directorate-General for Insurance and Pension Funds (*Dirección General de Seguros y Fondos de Pensiones,* "**DGSFP**")- which required the applicant insurer to submit an application for each destination Member State in

which they intended to provide services. Today, in fact, the procedure set out by the regulator is certainly aimed at an individualised notification referring to a specific country, as it requires "*the sworn translation into the official language of the Member State in which the insurance company intends to exercise the activity under the freedom to provide services*" (See electronic procedure TEL195 of the DGSFP's website, "Application to operate under freedom to provide services").

This distortion was even embedded in the Protocols for coordination between regulators. In the current EIOPA Decision on the collaboration of insurance supervisory authorities of January 2017, the system is far from being a single notification of operations throughout the Union to the regulator of the Member State of origin, but rather envisages a framework of collaboration and information that generates rigidity in the system (and where a country-by-country procedure is contemplated over a general authorisation of operations).

The system, which is not contested by Brussels, has worked reasonably beyond the classic debate on the distinction between operations under the FOS and operations under the right of establishment, in what has been known as the "grey area" (in this regard, see the Commission Interpretative Communication on the freedom to provide services and the general good in the insurance sector - 2000/C 43/03). However, it clashes with the reality of a common situation in pre-COVID-19 insurance (and one that will presumably return when levels of movement and changes of residence within the Union recover, once the pandemic has subsided and been defeated), as well as travel insurance and even many types of P&C insurance, where the insurer, without necessarily intending to operate under FOS in certain countries, can find itself insuring risks in jurisdictions that it never had in mind, at least commercially. And, even worse, often without being aware of it.

The system of the Directives on the Coordination of Insurance never intended for the recipient/client to be obliged to report changes of residence or even temporary moves, and thus ends up producing an inconsistency: despite having a licence which seemingly extends to the whole of the European Union, an insurer may not have made the mandatory notification of all its operations under FOS on a country-by-country basis, simply because it is not aware of them. Moreover, the whole system of the FOS is based on the General Good Provisions that every insurer operating under FOS must comply with in the Member State where it is providing the service; EIOPA lists each and every one of them (for Spain, for example, dated 20 July 2016, for undertakings), stating that, in accordance with Article 155 of the Solvency II Directive, "*where the supervisory authorities of a host Member State establish that an insurance undertaking with a branch or pursuing business under the freedom to provide services in its territory is not complying with the legal provisions applicable to it in that Member State, they shall require the insurance undertaking concerned to remedy such irregularity*". Major issues such as the law applicable to the contract, administrative obligations in relation to tax matters, even operations which are prohibited for small insurers etc., may be affecting insurers who find themselves inadvertently under the scope of FOS.

3. Conclusion

Does this mean that, in practice, most insurers are unknowingly violating the regulatory framework on the FOS? The answer is necessarily no. Starting with the infringement, if we refer to the case law of the Court of Justice, the perspective of the Advocate General on any approach to the concept of establishment and its scope seems to be extrapolable (for example, the case of Google Spain and Google, C-131/12, EU:C:2014:317). In other words, the stability of operations and whether business is effectively carried out in other Member States must be addressed when determining whether there is an establishment in another State. Similarly, an insurer who was unaware that the policyholder had changed residence cannot be accused of failing to make the mandatory notification to its supervisory authority about its operations under FOS in another Member State, or of failing to comply with the applicable General Good Provisions.

However, the issue may generate insurmountable collateral problems that go beyond the General Good Provisions. For example, the existence of risks in other Member States that were not apparent may lead to major practical difficulties in determining a portfolio, in the case of operations to transfer it or even discontinue operations in certain classes, or in insolvency proceedings that affect an insurer.

The Treaty on the Functioning of the European Union referred to at the beginning of this Briefing does not provide a solution, since, although it recognises that the FOS comes into play only in the absence of the right of establishment, it does not set a "threshold" rule above which an insurer can truly be considered to inadvertently fall under the scope of FOS in another Member State. And this threshold rule is, rather logically, necessary to deal with issues such as (i) whether a portfolio transfer process has to be carried out, with all its complex procedures, in cases where only a handful of people are residing in another Member State; or (ii) if a company has to be forced to introduce conditions subject to other legal systems and languages simply because a person moves to another State. Although, in theory, the answer to these questions would be yes, in practice everything depends on the regulator's point of view, which may be more or less flexible when it comes to remembering that this was not the FOS that was intended by the European legislator in the Treaties.

For more information,
please contact:

Joaquín Ruiz Echauri
Partner Insurance and Reinsurance
jruiz-echauri@perezllorca.com
T: + 34 91 432 51 58