



EUROZONE: CONTRACT CONSIDERATIONS

This guidance has been prepared jointly by the LMA and Clyde & Co LLP. It explores some of the specific considerations about how contracts may react in the event of one or more Eurozone countries switching from the Euro to a new currency.

By its very nature, this note is high level and does not address every eventuality. It is also important to note that there is a degree of legal uncertainty as to how particular clauses will be interpreted in the event of such a switch and how local courts will deal with contracts in light of the legislation which will trigger the re-denomination. However, this guidance aims to assist parties in achieving as much contractual certainty as is possible.

For the purposes of this guidance it is assumed that if a country exits the Eurozone it is likely to be one of the weaker economies and to re-denominate contracts from Euros to the new currency on a 1:1 basis. There are, however, other scenarios which could transpire, including that the Euro could cease to exist altogether.

Impact on contracts

If a Eurozone country were to switch from the Euro to a new currency this would be achieved through legislation (New Currency Legislation) which would set out a number of details including the exchange rate at which Euros would initially be converted into the new currency and would also provide for the automatic re-denomination of Euro denominated contracts in that country. The latter of these is of important consideration to contractual arrangements.

General contract considerations

There are a number of general principles and considerations which apply to all contracts when considering what the impact on a contract of a Eurozone exit would be, particularly the question of whether or not the contract will automatically re-denominate.

Some of the key general considerations are as follows:

- **What is the governing law and jurisdiction?** *Where the governing law and jurisdiction are those of the member state which exits the Eurozone the contract is more likely to re-denominate.*
- **What is the contract currency?** *If the contract is denominated in Euros and Euro is not defined as the single currency of the monetary union then the contract will be more likely to re-denominate.*
- **Where are the parties?** *If you are contracting with or through counterparties based in the exiting member state this will increase the probability of the contract re-denominating.*
- **Where is the place of payment?** *If the place of payment is in the exiting member state then this will increase the probability of the contract re-denominating.*

Where there are inter-connecting contracts how each of these contracts will react in the event of a re-denomination will need to be considered fully to understand the potential impact on a managing agent.

In general, for any contract, there will be two stages to a managing agent's analysis:

1. What is likely to happen to the contract in the event of a Eurozone exit?
2. What steps need to be taken to achieve the desired outcome/assist in providing contractual certainty?

Obtaining contractual certainty

Whilst there is no guarantee that a contract will react in a particular way in the event of a Eurozone country re-denominating to a new currency, there are clauses which can spell out the party's intentions and make it more likely that the contract will react in a particular way. It is also possible to use these clauses to improve the chances that interacting contracts (such as policies, distribution agreements, reinsurance etc) all react in a way which does not distort the economic effect of the overall arrangements.

Euro denominated

If a contract is denominated in Euros and the parties wish to determine how it will be treated in the event of a Eurozone exit, they can insert clauses to help achieve this. If they intend that it should remain in Euros they can include a Definition of Euro and a Re-denomination prevention clause. If instead they intend that it should re-denominate to the new local currency then they can include a re-denomination clause.

As an alternative the parties could include a clause which converts a Euro-denominated contract into, for example, USD or GBP. However there are some enforceability issues with such a clause. Whilst it is likely that this would succeed if the contract were subject to English law and it was examined by an English court, the same cannot be said for other governing laws and jurisdictions. In particular this clause could be viewed negatively by courts in a jurisdiction which exits the Eurozone and they may also seek to seize jurisdiction over the contract. However, such clauses are likely to be desirable in the outwards reinsurance agreements of UK-based managing agents where multiple currencies may already be in use within the contractual framework and the contract is governed by English law. It is not possible to provide a template clause for these purposes as the drafting will need to take account of the overall contractual arrangements and will be very specific to the particular contract. In the context of such a clause you will need to consider what happens to any payments which have been made under the contract before the redenomination. One possible solution would be to address this through an appropriate exchange rate in the contract which would put the parties in the same position as if the contract had been denominated in the new contract currency from inception.

Exiting state governing law and jurisdiction

Avoiding Eurozone governing law and jurisdiction (particularly those jurisdictions considered at higher risk of an exit) makes sense if the parties do not want the contract to redenominate to the new currency in the event of a Eurozone exit. Conversely, if it is the intention of the parties that the contract would redenominate in these circumstances then it would be better if the governing law and jurisdiction were those of the exiting member state.

Contract continuity

To mitigate the risk of the contract terminating in the event of a Eurozone exit the Euro contract continuity clause published jointly by the LMA, IUA and LIIBA on 7 August 2012 (LSW1820 (08/12)) should be used.

Issues to consider

The issues which will arise in relation to a contract are case specific and will depend upon the intention of the parties in any particular case. However, set out below are some key issues which a managing agent may wish to consider:

- What is the number and value of your Euro/Eurozone policies?
- What is the domicile/residence of the insured or the location of the insured property?
- Is there a high risk of this territory exiting the Eurozone?
- Do you have facultative reinsurance for this policy and, if so, is it important that this remains back-to-back with the underlying policy?
- Is the policy protected under your reinsurance treaty arrangements and, if so, is it important for relevant programmes to react in the same way as the underlying book of business in terms of currency, or is it more important that the reinsurance arrangements remain unchanged?
- If a policy will redenominate, will any connected distribution agreements and services contracts (and vice versa)?
- Do you have a local coverholder in a high risk territory? If so:
 - what are its banking arrangements and how much does it typically hold?
 - does it issue certificates on the basis of an agreed pro forma and, if so, what law and jurisdiction does the certificate stipulate?
- What is the impact on multi-country arrangements?

Other publications

The LMA published a guidance note on 8 June 2012, which discussed a number of points relevant to premium and claims settlement and terms of business agreements (TOBAs):

<http://www.lmalloyds.com/EURO>

Clyde & Co has published a number of materials relating to the Eurozone crisis and in particular considering the impact of the Eurozone crisis on insurers:

<http://www.clydeco.com/insight/articles/eurozone-crisis-and-the-possible-impact-on-insurers>

http://www.clydeco.com/uploads/Files/Publications/2012/CC000550_Eurozone_Article_-_Insurance_23_01_12.pdf

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SCHEDULE - SAMPLE CLAUSES

These are sample clauses which may be appropriate in particular circumstances to achieve particular aims. The LMA does not intend to devise model clauses in these areas, because such clauses need to be drafted according to the contractual position under consideration and the intentions of the parties.

Definition of Euro

Euro means the lawful currency of the member states of the European Union that have adopted and retained a common single currency through monetary union in accordance with European Union treaty law, as amended from time to time, and € or EUR shall be taken to mean the same.

Re-denomination Clause¹

If the the Euro ceases to be recognised as the lawful currency of the Insured's country of domicile then:

- (i) all payments and currency values under this Agreement shall be in the new lawful currency of the Insured's country of domicile; and
- (ii) unless prohibited by the Applicable Law any conversion from Euro to the new lawful currency of the Insured's country of domicile shall be at the official rate of exchange recognised by the government of the Insured's country of domicile/[bank name] at the date the Euro ceases to be the lawful currency of that country.

Re-denomination Prevention Clause

If the Euro ceases to be recognised as the lawful currency of the Insured's country of domicile then all payments and currency values under this Agreement shall remain in Euros.

or

(based on LSW 1820 and 1156)

- 1) In relation to all Euro Limits defined in or in connection with this Contract where there has been an event associated with the economic and monetary union in the European Union such Euro Limits will remain in Euros.
- 2) As used in this Clause, "Limits" means any priority, indemnity, premium, return premium, aggregate limits and sub-limits expressed in this contract.

¹ Please note that this clause is most likely to be desirable in respect of direct property insurance contracts where property is located in a Eurozone member state and not in respect of liability contracts.