16 May 2024

Insurance Europe key messages on the Late Payments Regulation

General key messages

- The proposed legal instrument (a regulation and not a directive) disproportionately interferes with:
  - the freedom of contract that is protected by the constitutions of several Member States; and
  - their civil and contract law.
- The proposal would adversely impact the competitiveness of European undertakings on a global scale as their international business partners are not as heavily regulated and will be able to propose longer and more flexible payment periods.
- By establishing a single payment period, the proposed regulation is not taking into account the specificities of certain lines of business such as the retail industry and the hospitality industry, which have very specific seasonal patterns, or indeed, the insurance industry, as explained below. The heterogeneity of practices applied in commercial transactions today reflects the diverse national legal frameworks and practices as regards B2B relationships as well as the diverse characteristics of industries in terms of different lengths of supply chains, different selling periods and different production cycles.
- Imposing a short and mandatory payment period does not allow undertakings to have the necessary flexibility to adapt in times of crisis.
- The proposal aims at tackling late payment behaviour. Under the current Late Payment Directive, undertakings have until 60 days to complete B2B payments, unless parties decide otherwise, provided that it is not "grossly unfair". This Directive did not help tackling late payment behaviour by solely implementing a payment period of 60 days. Merely decreasing the payment period to 30 days and rendering it non-negotiable will not help resolving the late payment behaviour that can be observed today. There is no correlation between altering the contractual limits of payment terms and improvement of late payment behaviour.
- A recent study published by Allianz[1] suggests that profitability of companies is the main determinant of payment terms. When companies' profitability increases, they have more leeway in managing their payables and receivables and their payment behaviour improves. In this context, the study foresees that "the looming profitability squeeze in Europe suggests that payment terms could worsen significantly in the region", irrespective of a change of legislation.
- SMEs, when selling products or services, would benefit from a short term of payment, assuming such term is complied with. However, SMEs do not only find themselves in creditors' shoes, but also in debtors'. Such a proposal could deepen the liquidity challenges many SMEs are facing today by not addressing late payment behaviour by some of their creditors. Indeed, as it is suggested by Allianz's study, the reduction of payment terms to 30 days would require companies in the European market to "find close to EUR2trn in extra financing. Given current bank interest rates, this would imply an extra financing cost of up to EUR100bn in interest expenses per year for European companies alone".
- The proposal establishes enforcement authorities (Articles 13 to 15) that would be responsible for supervising the proper implementation of the Regulation. The establishment of such authorities may create substantial administrative burden and bureaucratic costs while creating a "parallel" system to the competent courts and tribunal of the Member States.

1 Allianz Research, The cost of pay me later – 1 in 5 corporates globally pay their suppliers after 90 days, Ana Boata, Ano Kuhanathan, Maxime Lemerle, 4 April 2024.

- Ongoing changes to EU banking rules as part of the implementation of Basel III standards, which reduces SMEs' capacity to get loans, combined with the Late Payments Regulation proposal, may increase SMEs' difficulties in accessing funding solutions offered by financial services. Therefore, a strict, fixed maximum period would cause liquidity problems for vulnerable companies that are economically dependent on longer payment periods. This would impact in particular SMEs, whose competitiveness the EU wants to improve with the proposed regulation.

Insurance-specific key messages

- The insurance and reinsurance industry should clearly be excluded from the scope of the Regulation. A new paragraph (3a) under Article 1 should state: "This Regulation shall not apply to insurance and reinsurance undertakings as defined in Article 13 paragraphs 1 and 4 of Directive 2009/138/EC."

- The purpose of (re)insurance contracts is not to conclude commercial transactions but to provide insurance coverage. (Re) Insurance contracts have unique features that cannot be considered equivalent to classic commercial contracts that end after the agreed upon commercial transactions are completed.

- The mandatory 30-day payment period is triggered by the receipt of the invoice by the debtors. However, an insurance company receiving a claim report from the policyholder cannot be considered equivalent to a debtor receiving an invoice from its creditor. The objective of insurance compensation is to restore damage, not to receive a service. Sometimes, expert advice is needed to set the amount of compensation. Besides the payment is not always done to the customer, but to a third party (e.g., a family member that is covered by the insurance, a person suffering damage/injuries from an accident, that is to say the victim, a beneficiary of life insurance).

- The proposal, which is only meant to lay down rules for commercial transactions, interferes with (national and EU) sector-specific legislation, which would be problematic for the insurance industry, as a highly regulated sector.
  - Claims stemming from insurance contracts are subject to special maturity rules according to national insurance contract regulations. This takes into account that the settlement of many claims is complex and time-consuming.
  - As an example, article 22 of the Motor Insurance Directive sets a 3-month time limit from when the injured party presented their claim for compensation.
  - Legal uncertainty will therefore increase as two different payment periods would be applicable in certain situations, regulated by the Late Payments Regulations on the one hand and by sector-specific legislations on the other.
  - Several Member States also have specific default interest rates applicable to claim payments made by insurers. Those interest rates can be higher than the one established by the proposal, which will create further legal uncertainty for insurers.

- The European Parliament's first reading position implies much uncertainty, because it is not clear what exactly is in scope for insurers. Indeed, the implied extension of the scope by including "compensation" paid by insurers (amendments 38, 102 and 105) would, if understood as also applying to the process of claims settlement, be incompatible with how insurance works and would, as such, be impossible to implement.

- In case of complex claims, determining liability, the value of the damage, and the compensation amount owed within 30 days is often not possible.

- The proposal also goes against insurance contracts specific to certain areas where there is a delayed manifestation of the damage, such as environmental damage, long-term injuries or crop insurance. Indeed, for the crop insurance example, in case of damage caused in the early period of fruit development, the insurance company can only estimate the damage and the compensation owed. The final determination of the amount of the loss is made at a later date. Such date is set taking into account plant biology. Should the proposed amendments enter into force, the availability of crop insurance would be significantly impacted.

- Insurance policy wordings may include claim notification clauses that are adapted to local market practices. Should the proposal be successful, it would mean the majority of insurers with clients in the EU, not only the ones headquartered in the EU, would have to adapt and/or clarify the language they typically include in policy wordings.

- The proposal is also binding for trade credit insurance. Trade credit insurance covers the risk of default of accounts receivable from the supply of goods and services. The trade credit insurer will reimburse undertakings when their customers are unable to pay because of insolvency or in case the payment is long overdue. Therefore, the proposed regulation may increase the risk of insurance claims under trade credit policies and adversely affect companies' access to financing solution, broadening the financing gap.

- However, apart from operations linked to insurance contract and claims, insurance companies will be affected, just like any other company, by the change in payment period in their regular commercial relationships with their suppliers (e.g. costs associated with occupied buildings such as rentals, fixtures and fittings, purchase of electricity…).