



Institute  
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of Actuaries

# Brexit from the Perspective of an EU 27 Based Insurance Group

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# AZ Group and AZ SE Exposure to Brexit

Category	Entity	Domicile	Business Description
1 - UK Entity	AZ UK	UK	Retail and commercial business
2 - Reinsurers	AZ SE	Germany	Reinsurance (both Allianz and outside entities)
	AZ Re Dublin	Ireland	Reinsurance (Allianz entities only)
3 - Companies with significant exposure that will still operate in the UK	Allianz Global, Corporate and Specialty	Germany	Large commercial and specialty accounts - worldwide
	Euler Hermes	Belgium	Commercial Credit insurance
	Allianz Partners Health & Life S.A	France	Health insurance (primarily coverage for ex-pats)
	Allianz Partners P&C S.A	France	Travel insurance and assistance
	Allianz plc (Ireland)	Ireland	Retail and commercial business
	AZ Germany	Germany	
4- Companies with incidental exposure		Belgium, Netherlands, Luxembourg	
	AZ Benelux		
	AZ Italy	Italy	
	AZ France (IARD and Vie)	France	
	AZ Austria	Austria	
	AZ Czech Republic	Czech Rep.	
	AZ Spain	Spain	

Asset Management Companies – Continuation of Business			
Category	Operating Entity		European Domicile
Asset Managers	Allianz Global Investors	Legal Entities	Germany
		Investment Funds	Germany, Lux, UK, France
	PIMCO	Legal Entities	UK, Germany
		Investment Funds	Ireland, Lux



# AZ Group and AZ SE – Key Brexit Issues

## Key Issues

**Continuation of Coverage** - EU insurers will have no right to service policies or handle claims in the UK after Brexit even on policies written before March 2019

**Ability to write business after Brexit** - EU insurers will have no right to write business in the UK without a UK license after Brexit

**Reinsurance flexibility** - Uncertainty as to whether insurers in the UK will still be able to use reinsurers not licensed in the UK

**Treatment of derivatives** - Certain derivatives cleared in London may not be used as risk mitigation or may need to be moved into the EU after Brexit

**Licensing of rating agencies and risk capital calculations** - Ratings from rating agencies with UK licenses and no licenses elsewhere in the EU cannot be used in Standard Model SCR calculations potentially affecting spread risk, concentration risk and counterparty risk

**Data protection and data transfer** - Will insurers be able to transfer data between the UK and EU, and what is the risk of conflicting data protection requirements?



# Brexit Example – Continuation of Coverage

January 1 2019	February 15 2019	November 1 2019	November 5 2019	November 15 2019	December 15 2019	December 31 2019	April 15 2020	April 15 2020	January 15 2021	March 15 2021
Auto and liability policies incept	Insured has at-fault auto accident	Brexit Effective	Insured has acquired 5 new autos that must be endorsed on the policy	Insured has a customer slip and fall on their premises	OE settles auto claim	Policy expires	Product liability claim filed for an injury that occurred six months earlier	Settlement talks fail on slip and fall claim and OE is sued by plaintiff	Trail on slip and fall ends and insured loses. OE must pay claimant GBP 1mn	Product liability claim found to be fraudulent and closed
Activity legal under passporting			No more passporting – activity not legal under passporting							



## AZ Group – Options for Operating Entities (OE) with Significant Exposure

Option	Application Process	Solves Coverage Continuation Problem	Capital Intensity (Capital Costs)	Regulatory Acceptability	Other
Branch Application	Expensive and time consuming	Yes	Most efficient, but with uncertainties	Preferred option	Ultimately selected
Legal Entity Application	Expensive and time consuming	Requires separate legal proceeding	Capital intensive	Preferred option	
AZ UK Fronting	None	Requires separate legal proceeding	Relatively efficient	Not acceptable	Subjects AZ UK to undue regulatory risks and costs
Use of a Fronting only Entity	Expensive and Time consuming	Requires separate legal proceeding	Relatively efficient	Not acceptable	
Write on AZ UK Paper	None	Requires separate legal proceeding	Capital Intensive	Possibly acceptable	Subjects AZ UK to undue regulatory risks and costs
Write on New Allianz Entity Paper	Expensive and Time consuming	Requires separate legal proceeding	Capital Intensive	Possibly acceptable	



# AZ Group – Options for Operating Entities (OE) with Significant Exposure

Risk Capital Impacts of Brexit			
	European Operations	UK Operations	Total
<b>Basic Data</b>			
Premium	1500	1500	3000
Risk Capital (IM)			1000
Ratio IM/SM			67%
Risk Capital (SM)			1500
Own Funds			1300
Solvency II Ratio			130%
<b>Branch Scenario - no restrictions</b>			
Risk Capital (IM)			1000
Risk Capital SM		750	1500
Own Funds		975	1300
SII Ratio		130%	130%
<b>Separate Legal Entity Scenario</b>			
Risk Capital (IM)	500		1250
Risk Capital SM		750	1625
Own Funds	650	975	1625
SII Ratio			130%
<b>Needed Additional Own Funds to Achieve SII Ratio of 130%</b>			<b>325</b>
<b>Percent Increase in Own Funds</b>			<b>25%</b>
Loss of geographic diversification impacts are ignored			
Key Assumptions:			
Insurer maintains a SII ratio of 130%			
Internal model risk capital is 33% lower than standard model			
Impact from loss of geographic diversification is de minimis			

Primary driver of increase in risk capital is difference between internal model and standard model

No additional capital needed for TCB model assuming full fungibility of funds held in the UK

Significant increase in risk capital needed in a legal entity scenario. Might well see similar results if regulators determine that funds held in the UK cannot be considered fungible even with a branch

Impact of Risk Capital Changes on Insurance Pricing			
	European Operations	UK Operations	Total
<b>Basic Data</b>			
Premium	1500	1500	3000
Own Funds			1300
Cost of Capital			10%
Needed Profit to Support Capital	65	65	130
<b>Branch Scenario - No Restrictions</b>			
Own Funds			1300
Cost of Capital			10%
Needed Profit to Support Capital	65	65	130
<b>Separate Legal Entity Scenario</b>			
Own Funds	650	975	1950
Cost of Capital			10%
Needed Profit to Support Capital	65	97.5	162.5
Additional Needed Profit	0	32.5	32.5
<b>Addtl Profit as a % of Premium</b>	<b>0.0%</b>	<b>2.2%</b>	<b>1.1%</b>
<b>Key Assumptions:</b>			
Cost of Capital is 10%			
Income tax effects are ignored			

Increase in needed capital would result in an increase in economic costs and depending on market conditions a commensurate increase in pricing



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## Brexit: Insurance – UK Transitional Regulatory Regimes

Category	Purpose	Eligibility	Authorities	Duration
Temporary Permissions Regime (TPR)	Provide authorization to do business while Third Country Branch (TCB) or Subsidiary (LE) application is being reviewed	Companies that have pending TCB or subsidiary applications.	May continue to transact business as they have done in the past while application is pending in anticipation of approval of application	Depending on Brexit vote up to 3 years with further extensions possible
Financial Service Contract Regime – Supervised Runoff (SRO)	Allows runoff of business in force as of the Brexit date	Companies with incidental business in the UK on a Freedom of Establishment basis (UK FOS Branch)	May service existing contracts and also act to reduce or transfer the risk of those contracts. May also perform other activities to meet regulatory or legal requirements. May not write new or renewal policies.	15 years on insurance policies
Financial Services Contract Regime – Contractual Runoff (CRO)	Allows runoff of business in force as of the Brexit date	Companies with incidental business in the UK on a Freedom of Services basis (passporting) and are supervised by their home state regulator		



# Brexit for Insurers that Write Incidental Coverage in the UK

## Brexit and Data Processing Issues

### Insurers that Write Incidental Coverage in the UK

- **Reasons for incidental coverage (examples)**
  - Corporate accounts with locations in the UK
  - Coverage for long term insureds who have moved to the UK either temporarily or permanently
  - Coverage for vehicles (e.g. boats or airplanes) that are registered in the UK, but are actually housed elsewhere in the EU
- **Possible actions**
  - Non-renew before implementation of Brexit
  - Maintain until expiration taking advantage of contractual runoff scheme
  - Write in UK licensed entity and reinsure back (Allianz Multinational)

### Data Processing Issues

- **Under a no-deal scenario the UK becomes a third country under the EU General Data Protection Regulation (GDPR) subject to the same EU for the transfer of personal data as other third countries.**
- **Possible actions**
  - For data transfers within the Group „Binding Corporate Rules“ can be developed and implemented that will require adherence to a specific code of conduct around data privacy
  - For data transfers to outside parties „standard contractual clauses“ must be included in the contracts with these suppliers.



# Brexit: Derivatives

## Brexit: Rating Agencies

### Derivative Positions and Transactions

Under a hard Brexit scenario insurers may lose the ability to benefit from the risk mitigating impact of derivatives with UK banks

Cluster	New Transactions	Outstanding Transactions
<b>OTC Bilateral</b>	<ul style="list-style-type: none"> <li>For EU entities post Brexit transactions can be executed with EU or US counterparties - Many UK counterparties are developing EU-based affiliates</li> </ul>	<ul style="list-style-type: none"> <li>Outstanding transactions are not affected, as long as no action is taken. France and Germany are preparing legislation to give regulators temporary powers to waive license requirements</li> <li>Many banks are preparing transfer to EU-based affiliates in which case derivatives may be transferred or unwound and rewritten</li> </ul>
<b>OTC CCP</b>	<ul style="list-style-type: none"> <li>To the extent there is adequate liquidity, positions can be placed with Eurex rather than in London.</li> </ul>	<ul style="list-style-type: none"> <li>With the announcement for temporary clearing in the UK by the EU Commission outstanding transactions placed no later than March 2020 remain valid until the positions are closed. Germany is proposing legislation to allow continued validity.</li> </ul>
<b>ETDs</b>	<ul style="list-style-type: none"> <li>ETDs should be executed by EU 27 brokers who will then subclear the transactions in London</li> </ul>	<ul style="list-style-type: none"> <li>ETDs entered into before Brexit will continue to be recognized by the EU</li> </ul>

### Rating Agencies

- **Under a no-deal Brexit UK based rating agencies lose their permissions in the EU meaning that credit ratings cannot be used in risk capital calculations (definitely for the standard model)**
- **Actions**
  - Agencies opening or using EU based branches (e.g. Moody's in Germany, AM Best in the Netherlands)
  - ESMA and FCA have entered into a memorandum of understanding on cooperation which is one step for the rating agencies to obtain the needed permissions
  - Other actions are needed by European and UK regulators



## Solvency II Ratio Impacts – Hard Brexit

United Kingdom		
Risk Item	Expected Movement	Impact on SII Ratio
Interest Rates	Flat to Down	Differs by entity
Spreads	Up	Decrease
Equities	Down	Decrease
Inflation	Mixed	Unclear
Premium (Loss Ratio)	Up	Decrease
Reserves	Up	Decrease

Continental Europe		
Risk Item	Expected Movement	Impact on SII Ratio
Interest Rates	Flat to Down	Differs by entity
Spreads	Up	Decrease
Equities	Down	Decrease
Inflation	Flat	None
Premium (Loss Ratio)	Flat	None
Reserves	Flat	None



# Questions

# Comments

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