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# Brexit – setting up an Irish subsidiary

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13 November 2018

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# Brexit

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# Brexit

- Pre-EU referendum (23 June 2016), Royal London Group (RLMIS) already has presence in the EU through its branch in Ireland.
- Brexit (29 March 2019) brings an uncertainty over UK and EU trading agreements, in particular a potential loss of passporting rights.
- To ensure it can continue servicing its EU policyholders lawfully and continue to write insurance business in Ireland, RLMIS has assumed since early 2018 that a hard Brexit will happen and has implemented a project to continue operating in the EU post-Brexit.
- This involves setting up a subsidiary (RL Insurance DAC) in Ireland to write future life business as well as undergo a Part VII transfer of the existing European business from RLMIS to RL Insurance DAC with effect from 1 January 2019.

**Note:**

This presentation does not go into detail on all aspects e.g. legal, operational, tax, custodian, financial reporting etc.

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# Why an Irish subsidiary?

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## Why an Irish subsidiary?

- RLMIS already exists as a branch in Ireland with infrastructure in place.
- In 2017, the branch requirements in Ireland had not been fully established. With the Brexit negotiations still ongoing in 2017, RLMIS wanted the greater certainty of a subsidiary to ensure clarity on how it can operate in the case of a hard Brexit.
- The subsidiary demonstrates the self supporting ability to manage its business by having its own paid-up capital instead of relying on the parent as a single legal entity.
- Being a separate legal entity also means the subsidiary can manage its business separately from the parent.
- The subsidiary has its own governance structure dedicated to the Irish business, for example:
  - Board, with Non-Executive Directors
  - CFO, CRO
  - Head of Compliance
  - Head of Actuarial Function

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# Background of existing business to be transferred

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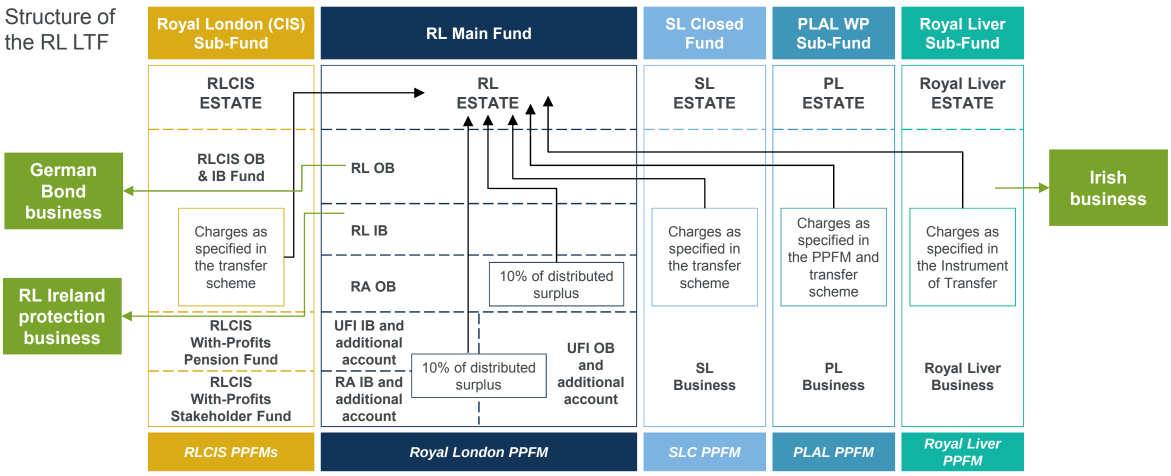
# RLMIS (pre-transfer to RL Insurance DAC)

Structure of the RL LTF




Source: Royal London PPFM

# Background of existing business to be transferred

Below shows the 3 blocks of existing business to be Part VII transferred:

## German Bond Business (RL Main Fund)

- Sold to German residents through RL360° (former subsidiary of RLMIS) and its predecessor Scottish Life International; administered in Isle of Man
- Written in RL Main Fund
- Closed to new business
- Mainly unitised with-profits business with some unit-linked business

## Royal Liver Sub-Fund

- Royal Liver Assurance acquired by RLMIS in 2011 and then transferred to the ring-fenced Royal Liver Sub-Fund of RLMIS through an Instrument of Transfer
- UK and Irish business with the latter including Royal Liver Assurance acquisition of Caledonian Insurance Company, GRE Life Ireland (GRELI), part of Irish Life Assurance and other business.
- Closed to new business
- Liver Ireland business includes significant proportion of with-profits business
- Largest of the 3 blocks to be transferred

## RL Ireland Protection Business (RL Main Fund)

- Written in RL Main Fund
- Open to new business*
- Protection business
- Smallest of the 3 blocks to be transferred

*This is the business to be written by RL Insurance DAC in the future.



# Background of existing business to be transferred

| Existing Business Transferring | Fund | Type of Business | YE2017 Gross BEL (£m) | Number of Policies |
|---|---|---|---|---|
| Ireland Liver Business | Royal Liver Sub-Fund | Non-Profit | 238.2 | 398,022 |
| | | With-Profit | 503.9 | 70,253 |
| | | Unit Linked | 13.3 | 1,014 |
| | | **Total** | **755.4** | **469,289** |
| German Bond Business | RL Main Fund | Unitised With-Profits | 118.1 | 1,307 |
| | | Unit Linked | 2.4 | 35 |
| | | **Total** | **120.5** | **1,342** |
| RL Ireland Protection Business | RL Main Fund | Non-Profit | -62.5 | 49,878 |
| TOTAL | | | 120.5 | 520,509 |

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# How the Part VII transfer works Reinsurance back to RLMIS (for Liver and German bonds)

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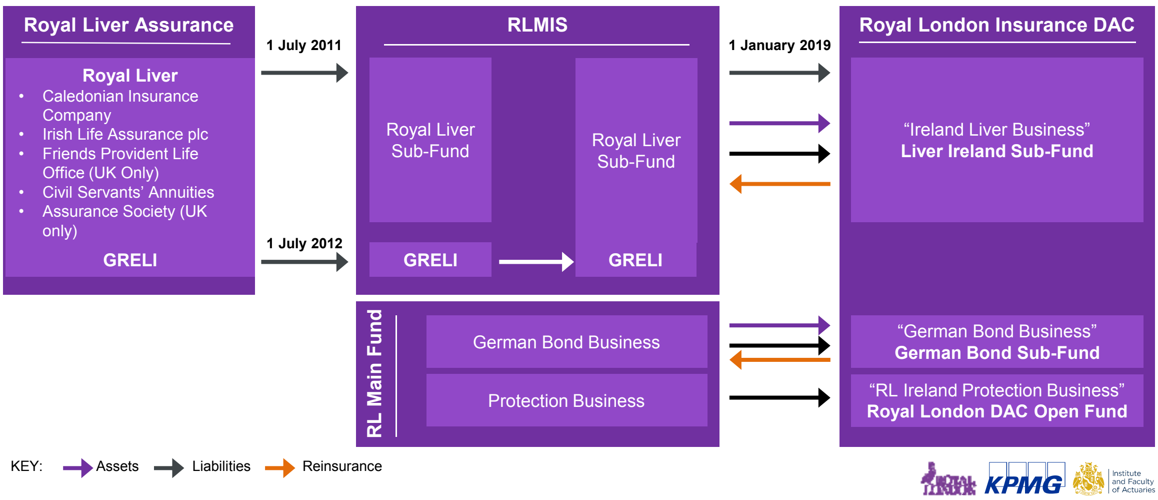
# How the Part VII transfer works



## Reinsurance to RLMIS (for Liver and German bonds)

- Liver Ireland sub-fund contains significant with-profits business. Reinsurance back to RLMIS Royal Liver Sub-Fund enables the business to continue to be managed in broadly the same way after the transfer as it is before the transfer (through consistent bonus rates) across the UK and Ireland business.
- German Bond sub-fund – reinsure back to RLMIS RL Main Fund under the German Bond Reinsurance Agreement as this is a closed book and is too small to operate economically as a with-profits fund in the absence of participation in, and support from, the RLMIS RL Main Fund.
- Royal London DAC Open Fund – post 2011 protection business will not be transferred back as it is of the same type that RL Insurance DAC is planning to write in the future.

✓ Keeps business economically intact.

✓ Meets expectations of both groups of policyholders and represents best interest to both groups.

✓ Avoids complex partitioning of Royal Liver sub-fund between transferring and non-transferring polices.



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## Timeline

# Timeline

| Late 2017 | Mar 2018 | Jun 2018 | Aug 2018 | Oct 2018 | Dec 2018 | Jan 2019 |
|---|---|---|---|---|---|---|
| Process starts | Application for subsidiary to CBI | Part VII documentation submitted to PRA/FC | IE report submitted | Directions hearing | Approval of Irish subsidiary | Final hearing and effective date of transfer |



## Key parties

| RLG | Regulators | Advisors |
|---|---|---|
| • RLMIS<br>• Staff of Irish branch (existing Ireland team) whom will continue to work at RL Insurance DAC | • Prudential Regulatory Authority<br>• Financial Conduct Authority<br>• Central Bank of Ireland | • KPMG (actuarial support)<br>• Pinsent Masons (UK legal counsel)<br>• Matheson (Ireland legal counsel)<br>• Grant Thornton (Independent Expert)<br>• Martin Moore (QC)<br>• Deloitte (Head of Actuarial Function) |



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# Project working groups and committees

## Project working groups and committees

Group Executive Committee

Group Finance Portfolio Control Board

Head of Group Finance Delivery | Programme Sponsor | Programme Manager

Steering Group

Legal, Finance, Actuarial, Ireland CEO and COO, Communications, Compliance, Operational Readiness, HR, IMAP

CBI Application

Operational Readiness

- Part VII Ops and Admin move
- Day 1 –Operations & Reporting
- Day 2

Part VII Transfer

Actuarial Working Group | Technical Design Group

IE Working Group | Business Design Group



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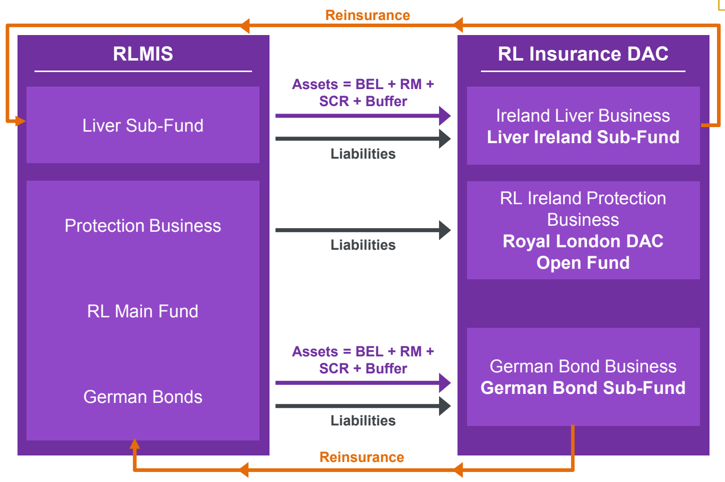
## Financial impact of the transfer

# Financial impact of the transfer

RL Insurance DAC will be managed on a Standard Formula basis with the SCR comprising mainly Operational Risk




KEY: Assets Liabilities Reinsurance

**Reinsurance Agreements**

INITIAL PREM = Gross BEL – BEL Counterparty Default Adjustment + (gross & net basis) (RM-SCR)

Assets transferred – Initial premium = Assets remaining = BEL Counterparty Default Adjustment, the RM, SCR and the capital buffer (all after allowing for the reinsurance)

- Experience adjustment to keep the capital coverage ratio of the businesses in line with the RL Insurance DAC capital management framework



# Risks of RL Insurance DAC post transfer

**Market risk**

Hold cash / euro-denominated government bonds – low interest rate, credit risk and concentration risk (depending on details of bonds).

No overseas assets – zero currency risk.

**Life underwriting risk**

Open fund – all life risks.

German Bond funds – all life risks hedged via reinsurance to RLMIS.

Liver Fund – small amount of expense risk retained due to requirement to retain profits and losses from expense agreement with Service Company. All other risks hedged via reinsurance to RLMIS.

**Operational risk**

Function of BSCR, earned premiums and technical provisions during the last 12 months.

**Counterparty default risk**

Minimise CDR SCR using collateral (see next section).

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# Reinsurance and collateral arrangements

Liver and German Bond funds

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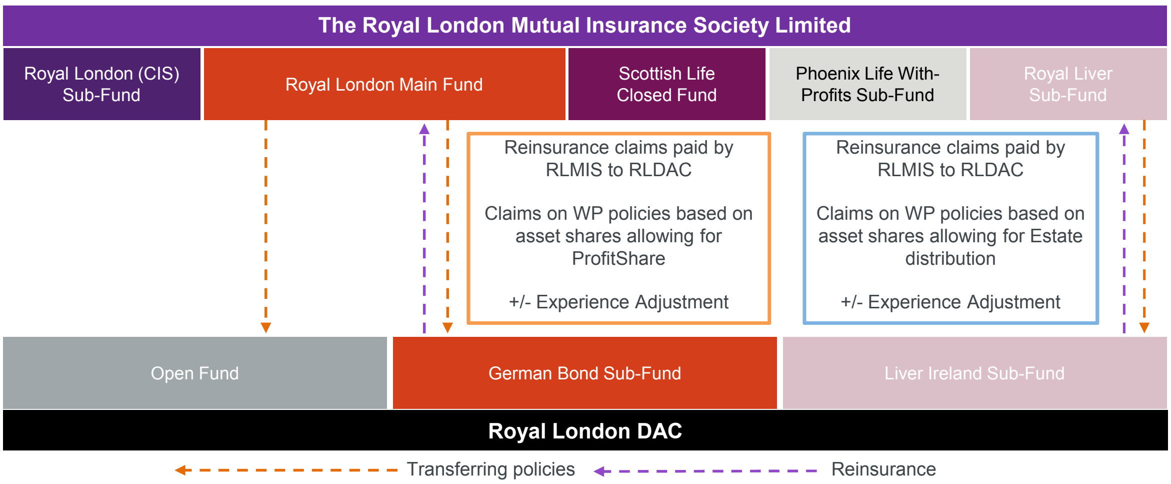
## Ongoing operation of the reinsurance arrangements

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# Reinsurance and collateral arrangements

- 2 reinsurance agreements between RL Insurance DAC and RLMIS – 1 for Liver and 1 for German bonds
- **Reinsurance introduces Counterparty Default Risk SCR for RL Insurance DAC**
- **Amount of SCR depends on Loss Given Default**

*Use Collateral to minimise LGD*

- Level 2 Article 192 – Loss Given Default
  - *Max (50% x (BE RI recoverables + 50% x Risk-mitigating effect) – F x Risk-adjusted value of Collateral,0)*
  - F = factor to account for economic effect of collateral arrangement in relation to the reinsurance in case of credit event of counterparty (see additional complication next slide)
- **Different types of collateral arrangements result in different SCRs:**

1. Level 2 Article 1 26(a) – transfer full ownership of collateral to collateral taker (i.e. RL Insurance DAC)
2. Level 2 Article 1 26(b) – provide collateral by way of security and legal ownership of collateral remains with collateral provider (i.e. RLMIS) / custodian

Option 2 is easier to implement in practice (although a further 10% haircut is applied to collateral compared to Option 1).

RL Insurance DAC adopted Option 2 using collateral framework agreements with charges over assets of the relevant RLMIS funds and allocated to a ring-fenced collateral account at the custodian.

Collateral assets will be cash and government bonds (£ and Euro).



# Collateral arrangements (additional complication)

- Level 2 Article 197 – Risk-adjusted value of collateral
  - Where in case of insolvency of the counterparty (i.e. RLMIS), **the determination of the insurance or reinsurance undertaking's proportional share of the counterparty's insolvency estate in excess of the collateral does not take into account that the undertaking** (i.e. RL Insurance DAC) **receives the collateral**, the factors F and F' referred to in Article 192(2) and (3) shall both be 100%. In all other cases these factors shall be 50% and 90% respectively.

The above interpretation means that in the event of RLMIS insolvency, the collateral may be affected by the insolvency estate i.e. RL Insurance DAC receives **less than 100% collateral** from RLMIS. The F factor will then reduced from 100% to 50% and increase the LGD and hence CDR SCR.

# Collateral arrangements – proposed solution

**Liver Reinsurance Agreement**
- Liver Collateral Framework Agreement
  - Tier 1 fixed charge on Liver sub-fund (50% BEL)
  - Tier 2 fixed charge on Liver sub-fund (50% BEL)

**German Bond Reinsurance Agreement**
- German Bond Collateral Framework Agreement
  - Tier 1 fixed charge on RL Main Fund (50% BEL)
  - Tier 2 fixed charge on RL Main Fund (50% BEL)

**Floating Charge over all RLMIS assets (excluding unit-linked funds)**

**Equalisation provisions in Tier 2 Fixed Charges & Floating Charge**

- In the event of RLMIS insolvency, RL Insurance DAC can obtain the Tier 1 collateral (with 100% F factor) first to allow it to continue to trade, while recovering the Tier 2 collateral (with 50% F factor) once equalisation process is completed.
- Floating charge ensures RL Insurance DAC reinsured policyholders rank pari passu with the RLMIS direct policyholders in the event of RLMIS insolvency.
- Equalisation provisions ensure the RL Insurance DAC reinsured policyholders do not receive more than the RLMIS direct policyholders in the event that there is a shortfall of available assets on the insolvency of RLMIS.



# Collateral arrangements – worked example

| Reinsurance recoverables | Tier 1 fixed charge / Tier 2 fixed charge / Total value | Adjustment for market risk | Collateral | F | BD70k mitigating effect (Rm) | Probability of default of RLMIS |
|---|---|---|---|---|---|---|
| **£100m** | Tier 1 fixed charge **£50m**<br>Tier 2 fixed charge **£50m**<br>Total value of assets held as collateral **£100m** | **-£12m** | **£88m** (risk-adjusted value) | F = 100% (Tier 1)<br>F = 50% (Tier 2)<br>F = 75% (weighted average) | **£4m** | **0.05%** (credit rating of A » credit quality of step 2) |

LGD $= \max(50\%*(\text{Recoverables} + 50\%*\text{Rm}) - F*\text{Collateral},0)$

$= \max(50\%*(100+50\%*4) - 75\%*88,0)$

$= 0$

**Slide 28**

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**BD70** I think it may be better to say 100% for Tier 1 and 50% for Tier 2 just in case PwC are there as they dont like a weighted average!
Bird, David, 06/11/2018

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# How the Irish subsidiary intends to manage its business post-Brexit

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LJ49

## How the Irish subsidiary intends to manage its business post-Brexit

- The CBI expects business to be standalone and act solely in the EU policyholders'' best interests
- Irish Service Company (Irish branch of RL Group service company)
- Admin moving to Dublin from UK for some business (the rest is already in Ireland)
- Expense agreements with Liver Fund
- With-Profits Operating Principles (similar to UK Consumer Friendly PPFM). RLMIS have a PPFM guide for the Liver and German Bond With-Profits business which is based on the RLMIS Liver and RL Main Fund PPFMs and is akin to the CFPPFM (and consistent with WPOP requirements as far as possible).
- Outsourcing from RL Insurance DAC to RLMIS, e.g. financial reporting
- Reinsurance of Liver and German Bonds businesses to RLMIS with Security Agreements to protect RL Insurance DAC policyholders

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## Slide 30

**LJ49** David to speak on this slide

Lim, John, 16/10/2018

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# Lessons learnt

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# Lessons learnt

Don't underestimate legacy documentation e.g. Liver Instrument of Transfer.

Anticipate regulators' and Court's views and demonstrate readiness and consideration of all areas to regulators.

SII rules can be subject to different interpretation – allocate sufficient time to understand, seek multiple views and assess impacts.


Engage with stakeholders e.g. regulators and IE early and ensure all parties are kept in the loop as many areas affect more than one stakeholder.

Engage Ireland expertise – actuarial and legal.

Things usually take time longer than expected so plan early!
E.g. interlinking of SII rules, interaction and consistency of documents.

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# Questions

# Comments

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