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Brexit: Where are we now ?

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Presentation to CILA Conference

14 May 2019

Introduction

- Summary of current status of Brexit
- Key areas of uncertainty for life insurers
- Key UK and EU legislative and regulatory developments
- What have other member states done ?
- What might change … and why it might not
- Q&A and discussion

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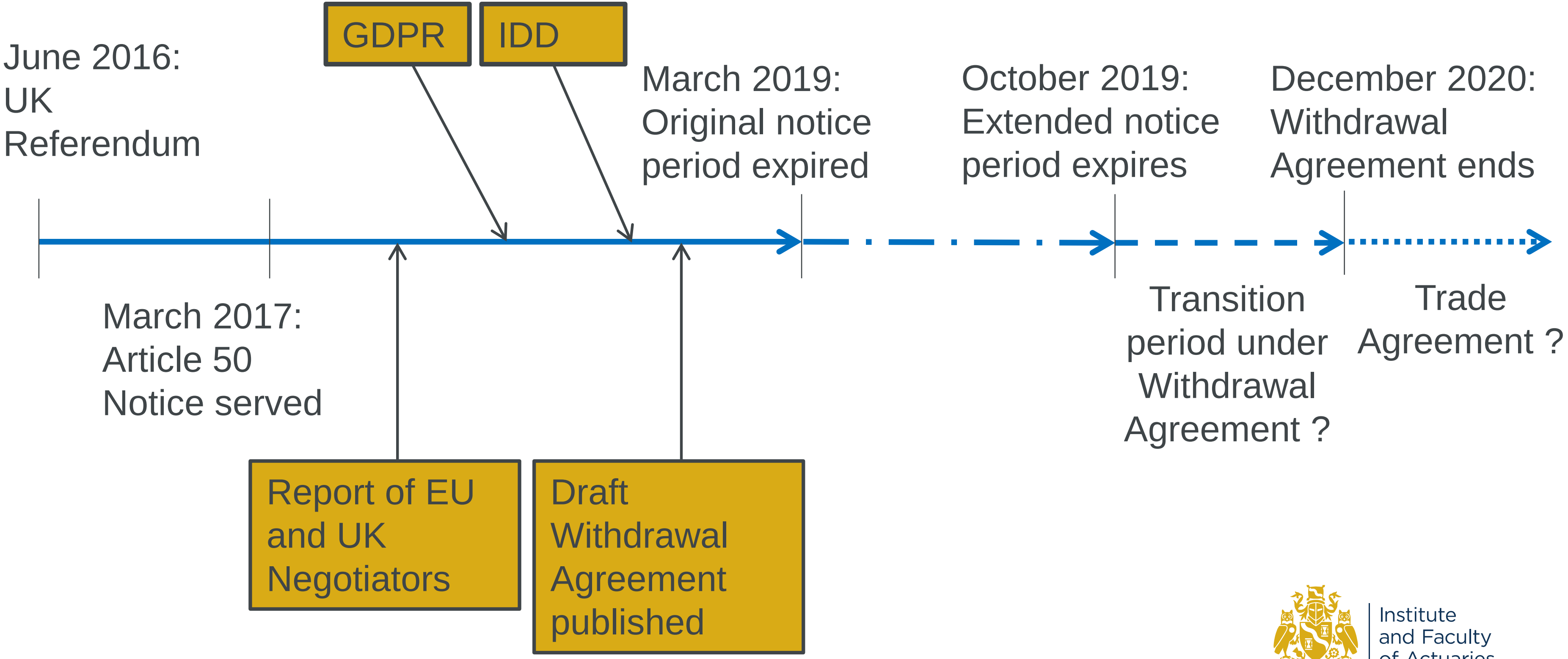
Status


June 2016: UK Referendum
GDPR
IDD
March 2019: Original notice period expired
October 2019: Extended notice period expires
December 2020: Withdrawal Agreement ends
March 2017: Article 50 Notice served
Report of EU and UK Negotiators
Draft Withdrawal Agreement published
Transition period under Withdrawal Agreement ?
Trade Agreement ?

Article 50 Notice

- **Treaty on the European Union**

Article 50

1. Any Member State may decide to withdraw from the Union in accordance with its own constitutional requirements.

2. A Member State which decides to withdraw shall notify the European Council of its intention. In the light of the guidelines provided by the European Council, the Union shall negotiate and conclude an agreement with that State, setting out the arrangements for its withdrawal, taking account of the framework for its future relationship with the Union. That agreement shall be negotiated in accordance with Article 218(3) of the Treaty on the Functioning of the European Union. It shall be concluded on behalf of the Union by the Council**, acting by a qualified majority,** after **obtaining the consent of the European Parliament**.

3. **The Treaties shall cease to apply to the State in question from** the date of entry into force of the withdrawal agreement or, failing that, **two years after the notification referred to in paragraph 2, unless the European Council, in agreement with the Member State concerned, unanimously decides to extend this period**.

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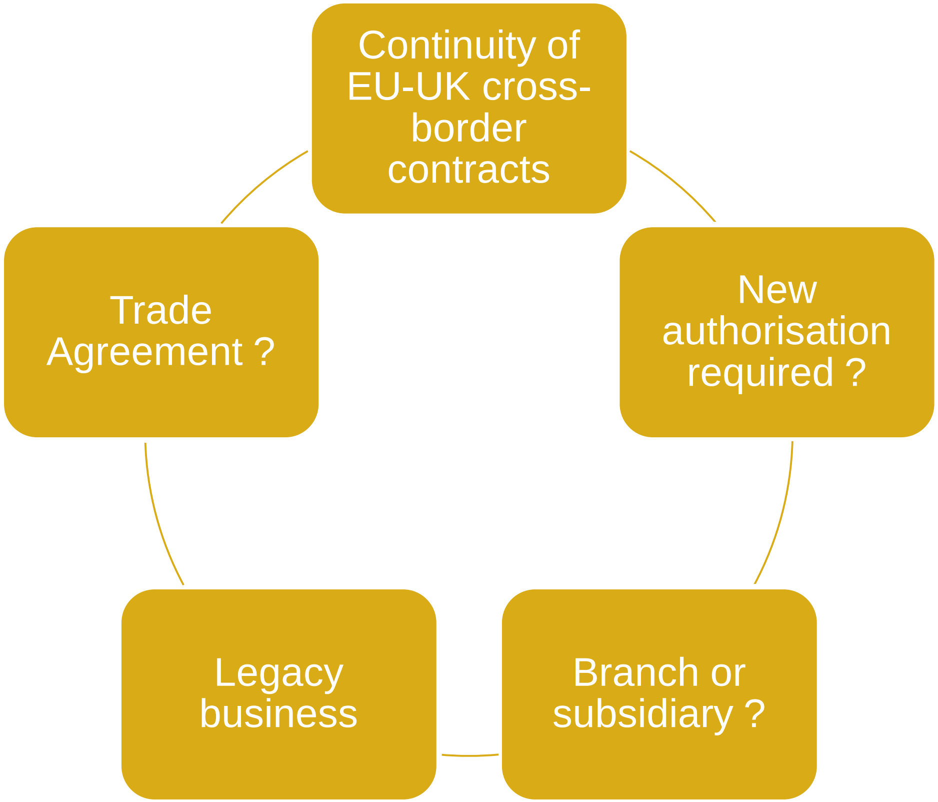
Some key areas of uncertainty



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Some key issues for life insurers

Business mainly sold through domestic subsidiaries	• So passporting generally not critical
But policyholders may move jurisdiction	• New authorisation required ?
Intra-group transactions	• Source of uncertainty and inflexibility
Group supervision	• New group supervisor ? New Internal model approval ? Duplication of reporting ?
Hoping for reform of rules that cause strain	• Will PRA lose influence if UK becomes a “rule-taker”? Will rules become even more onerous ?

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Deal or no deal – What might be the implications ?

Deal

- UK-EU passporting and insurance portfolio transfers
- UK can lead group supervision
- UK-EU reinsurance eligible

But

- UK will be a “rule-taker”, so status quo rules, with little influence over future changes

No Deal

- No UK-EU passporting or insurance portfolio transfers

Equivalence

- UK can lead group supervision
- UK-EU reinsurance eligible
- **But**
- Likely to be necessary for UK to be largely a “rule-taker”

No Equivalence

- UK can’t lead group supervision
- UK-EU reinsurance only eligible if collateralised or reinsurer rated BBB or above

But

- Flexibility for UK to change its rules

What might change ?

Key areas of interest:

- Passporting
- Insurance portfolio transfers
- Equivalence
- Group supervision
- Risk margin
- Matching Adjustment
- Internal model approvals
- Standard formula
- Authorisation of insurers
- Authorisation of branches of third country insurers, including of EU insurers

Importance of the non-life sector

£8 billion — Premium is brought annually to the London Insurance Market by brokers on behalf of EU customers

£6 billion — International business is written in London by firms with a parent company or principal base located elsewhere in the EU

US$432 billion — Non-life GWP (21% of worldwide non-life GWP) was written in the EEA (other than the UK) in 2015

Source: London Market Group report, 2017

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The importance of the status quo

Existing Solvency II framework took many years, and significant cost, for insurers to adopt

+

It is now an internationally recognised standard

→

Even if UK was given flexibility over its rules, free from a deal and the need for equivalence, it is unlikely to make radical changes

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Key UK legislation and guidance – "No deal" scenario

European Union (Withdrawal) Act 2018
Financial Services and Markets Act 2000 (Amendment) (EU Exit) Regulations 2019 Draft PRA Direction
Financial Services Contracts (Transitional and Saving Provision) (EU Exit) Regulations 2019
Solvency 2 and Insurance (Amendment, etc) (EU Exit) Regulations 2019
Equivalence Determinations for Financial Services and Miscellaneous Provisions (Amendment etc) (EU Exit) Regulations 2019
PRA Policy Statement 5/19: The Bank of England's amendments to financial services legislation
FCA Policy Statement 19/5: Brexit Policy Statement

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EIOPA Recommendations …

… on continuity of insurance contracts following no-deal Brexit – February 2019

- "competent authorities should apply a legal framework or mechanism to facilitate the orderly run-off of business which became unauthorised **or** they should require the insurance undertakings to immediately take all necessary measures to become authorised under Union law"
- the supervision exercised by member states should be "**risk-based and take into account proportionality**"
- "Competent authorities should prevent that UK undertakings conclude new insurance contracts or establish, renew, extend, increase or resume insurance cover under the existing insurance contracts in their jurisdiction as long as they are not authorised for such insurance activities under Union law …" But:
- "… without prejudice to policyholder rights to exercise an option or right in an existing insurance contract to realise their pension benefits"
- Where policyholder concluded contract in the UK and subsequently moved to EU "competent authorities should take into account in the supervisory review that the insurance contract was concluded in the UK and the UK insurance undertaking did not provide cross-border services for the EU27 for this contract"

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What have EEA member states done in response ?

Member State	Legal mechanism	Conditions of using legal mechanism	Does insurer need to take any active steps	Run-off Period
Denmark	-	Undertake not to carry on any new business in jurisdiction including no extensions	-	2020
France	Customers can continue to enjoy benefits of contracts concluded pre-Brexit	Undertake not to carry on any new business in jurisdiction	Notify customers of changes within 15 days	Not specified
Germany	Insurer is automatically given deemed permission	Undertake not to carry on any new business in jurisdiction post Brexit	No	Up to 21 months post Brexit, subject to revocation
Ireland	Insurer is automatically given deemed permission	Undertake not to carry on any new business in jurisdiction post Brexit	Notify regulator within 3 months Actively make arrangements to permanently cease insurance business in jurisdiction	3 years post Brexit, subject to revocation

What have EEA member states done in response ?

Member State	Legal mechanism	Conditions of using legal mechanism	Does insurer need to take any active steps	Run-off Period
Italy	Discuss with regulator	Undertake not to carry on any new business in jurisdiction post Brexit	Issuer must, within 90 days, submit a plan to the regulator (IVASS) Notify customers of changes within 15 days	-
Luxembourg	Discuss with regulator	-	-	Up to 21 months post Brexit, subject to revocation
Spain	-	Undertake not to carry on any new business in jurisdiction post Brexit	-	Up to 9 months post Brexit, subject to revocation

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Draft Withdrawal Agreement – What would it do ?

- Transitional period until 31 December 2020, during which status quo rules will be preserved for financial services
  - Passporting
  - Insurance portfolio transfers
  - Group supervision
  - Reinsurance
- But
  - UK is not a member of the EU, so influence over rule changes lost
  - Future trade agreement would need to be ratified by all EU member states, rather than simply approved by European Council - not so easy (although extensions still possible)
  - This means we will face all the same issues in the lead-up to 31 December 2020 ...

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Key messages

- There is considerable ongoing uncertainty
- But don’t expect significant changes to regulatory rules, whether or not the Withdrawal Agreement is implemented
- Loss of passporting is not generally problematic for life insurers, except where policyholders move jurisdiction
  - EIOPA Recommendations seem sympathetic to this, but need to see what individual member states say in practice
- Expect Brexit to be an issue for a long time to come …

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Contact for questions

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Questions

Comments

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Appendix

Reference materials providing further detail on some of the points discussed in the main presentation

Appendix

- Passporting
- Equivalence
- Third countries, authorisation under Solvency II, and implications for UK insurers
- Solvency II Framework
- Risk margin

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Passporting

- Two forms of passporting
  - Freedom of establishment: Article 49 of Treaty on Functioning of European Union
  - Freedom of services: Article 56 of Treaty on Functioning of European Union
- These provisions apply to "nationals" of a Member State of the EU
- Article 54 of the Treaty on Functioning of European Union extends these provisions to "companies or firms formed in accordance with the law of a Member State and having their registered office, central administration or principal place of business within the Union"
- Similar provisions in the EEA Agreement extend to the EEA countries (Iceland, Norway and Liechtenstein)
- Incorporated into Solvency II, Insurance Mediation Directive and Insurance Distribution Directive, with further procedural provisions
- But they do **not** apply to branches of third country insurers / reinsurers / intermediaries, even if the third country is "equivalent"

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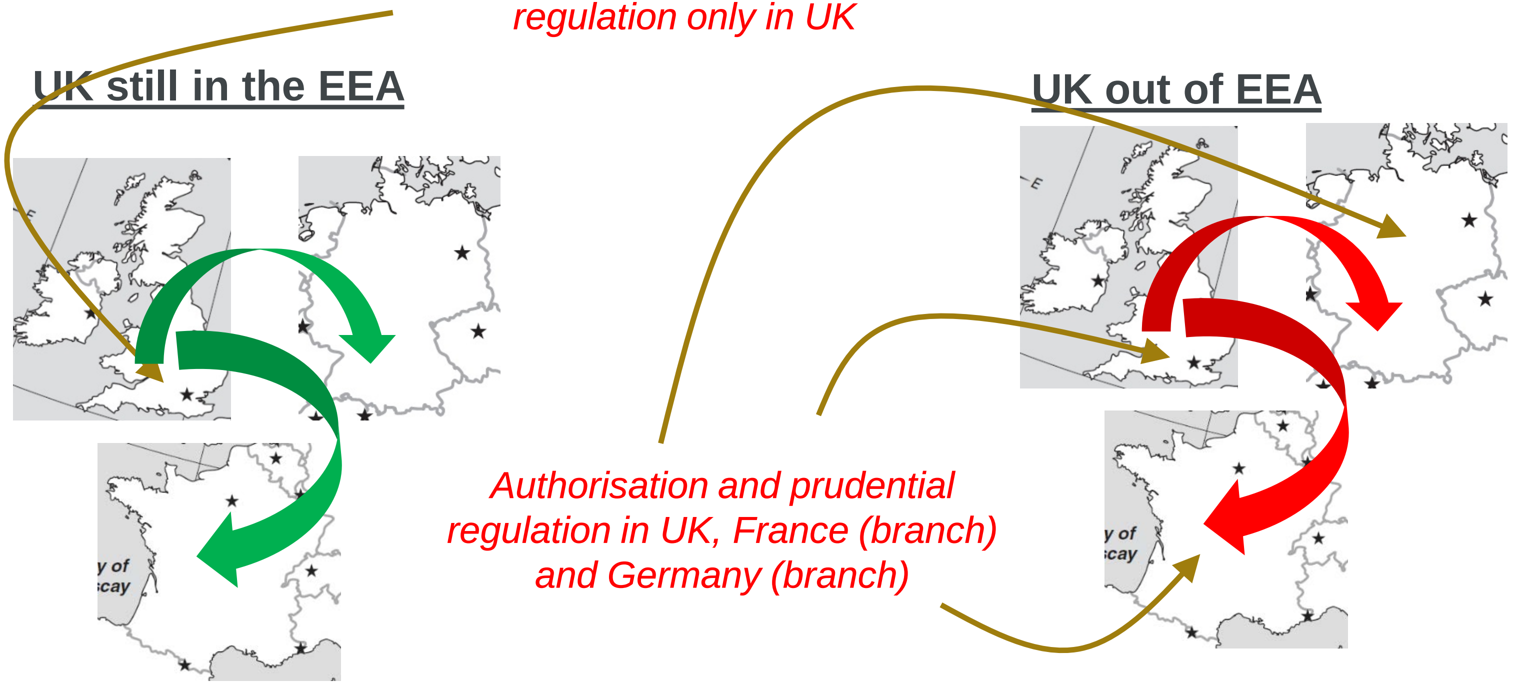
Passporting

UK still in the EEA | **UK out of EEA**



UK insurer passports into France and Germany though local branches German branch; authorisation and prudential regulation all by the UK regulator

Each branch requires authorisation by the local regulator as a branch of a third country insurer

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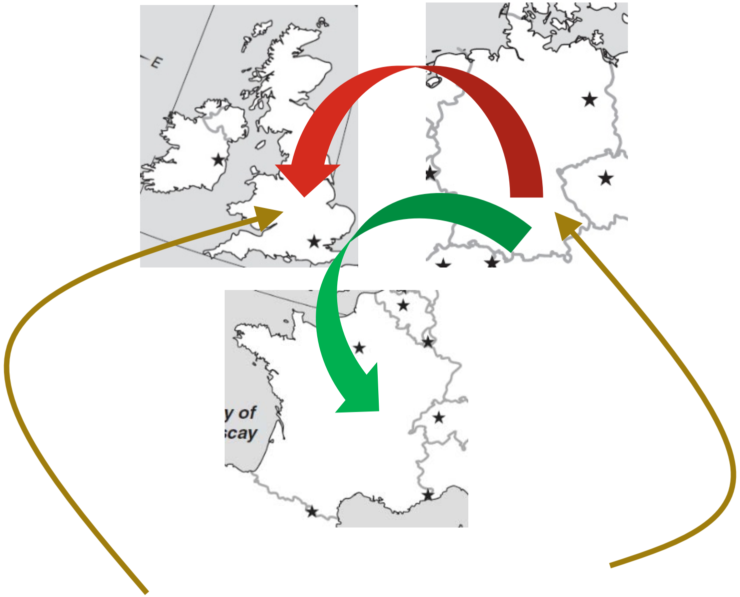
Restructuring to facilitate passporting

Possible restructuring



Authorisation and prudential regulation in UK (branch) and Germany

Establish German insurer which passports into Germany under Solvency II, and establishes a UK branch under UK rules governing establishment branches of third country insurers

What about existing business ?

- Reinsurance
- Transfer of business to German insurer under Part VII
- Convert insurer to Societas Europaea (SE) and transfer registered office

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Equivalence

- "Equivalence" for third country regimes under Solvency II
  - Article 172: Reinsurance solvency
  - Article 211 (of Solvency II Regulation): ISPV supervision
  - Article 227: Group solvency calculation (for deduction and aggregation method)
  - Article 260: Group supervision
- No corresponding "equivalence" provisions apply under IDD
- Equivalence does not give rise to passporting rights for third country firms

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Equivalence decisions made under Solvency II

Jurisdiction	Art 172 (Reinsurance)	Art 227 (Group solvency)	Art 260 (Group supervision)
Switzerland	Yes	Yes	Yes
Bermuda *	Yes	Yes	Yes
Japan	Temporary (5 years)	Provisional (10 years)	
USA **		Provisional (10 years)	
Australia		Provisional (10 years)	
Brazil		Provisional (10 years)	
Canada		Provisional (10 years)	
Mexico		Provisional (10 years)	

* Apart from captives and SPVs ** But note EU-US and UK-US Covered Agreements

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"Third" countries

- Third country undertaking: Solvency

  Solvency II, Article 13(3):

  "third-country insurance undertaking" means an undertaking which would require authorisation as an insurance undertaking in accordance with Article 14 if its head office were situated in the Community

- Following implementation of Brexit, and in the absence of other agreement:
  - The UK will be a "third country" with respect to the countries of the EEA
  - Each country of the EEA will be a "third country" with respect to the UK

Or might the UK regard the EEA as a whole as a third country ?

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Authorisation under Solvency II

- **Article 1:**

  This Directive lays down rules concerning … the **taking-up** and **pursuit**, within the Community, of the self-employed activities of direct insurance and reinsurance; …

- **Article 2:**

  1. This Directive shall apply to direct life and non-life insurance undertakings which are established in the territory of a Member State or which wish to become established there.

  It shall also apply to reinsurance undertakings which conduct only reinsurance activities and which are established in the territory of a Member State or which wish to become established there with the exception of Title IV.

- **Article 14:**

  1. The **taking-up** of the business of direct insurance or reinsurance covered by this

  Directive shall be subject to prior authorisation.

EIOPA: applies even if limited to run-off

- **Article 162**:

  1. Member States shall make **access to the business** referred to in the first subparagraph of Article 2(1) [**direct insurance business**] by any undertaking with a head office outside the Community subject to an authorisation.

  2. A Member State may grant an authorisation where the undertaking fulfils at least the following conditions:

  (a) it is entitled to pursue insurance business under its national law;

  (b) it **establishes a branch** in the territory of the Member State in which authorisation is sought; …

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Authorisation under Solvency II

> "a third country insurance undertaking may only insure risks located in a member state through a branch authorised by the competent supervisory authority of that member state";

European Commission: minutes of meeting on the "Expert Group on Banking, Payments and Insurance", July 2015 (commenting on Article 162)

This view is disputed:

- It is not the UK interpretation, which permits direct insurance by third country insurers provided they do not "carry on insurance business" in the UK ("**activity based**" approach)
- Other EU countries (eg France and Spain) apply it more literally and only permit direct insurance by third country insurers if they have a branch authorised in that country ("**location of risk**" approach)

What does this mean for insurers after Brexit ?

Assuming the UK incorporates Solvency II rules unchanged and treats EEA countries as "third countries" and EEA countries treat the UK as a "third country":

- If EEA insurers wish to "carry on insurance business" in the UK, they will need to establish a branch authorised in the UK

Subject to temporary permissions regime

- The same will apply to EEA pure reinsurers: although Article 162 of Solvency II is silent on pure reinsurers, the PRA has applied the same rules to branches of pure reinsurers (see rule 15.1 of "Third Country Branches", PRA Rulebook)
- However, if they do not "carry on insurance business" in the UK, they will not require an authorisation – see next slide
- UK insurers which wish to provide insurance to policyholders in EEA countries which adopt the "location of risk" interpretation of Article 162 will need to establish a branch in the relevant country
- Since third country branches cannot passport under Solvency II, a separate branch and a separate authorisation will be needed in each such country

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"Carrying on insurance business" in the UK

- Under the Financial Services and Markets Act 2000 (Regulated Activities Order) 2001, the relevant regulated activities are:
  - Effecting contracts of insurance
  - Carrying out contracts of insurance
- Applies irrespective of the location of the policyholder
- Various cases have interpreted quite widely:
  - *Stewart v Oriental Fire and Marine Insurance Co Ltd*.
  - *Re Great Western Assurance Co SA and ors*.
  - *DR Insurance Co v Seguros America Banamex*.
- Includes sourcing business, selecting opportunities for consideration, negotiating terms, binding risks, paying claims and amending contracts.
- But not mere representative office in the UK, and not activities outside the UK.

So an insurer operating within the UK would be caught even if all its policyholders were outside the UK

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Solvency II regulatory framework

PRA Rulebook

- EU insurance regulatory framework

LEVEL 1	Solvency II Directive	*Not directly effective. Each EU member state is required to implement by its own national law*
LEVEL 2	Solvency II Regulation Implementing Regulations	*Automatically directly effective as law in every EU member state*
LEVEL 3	EIOPA Guidelines	*Not strictly legally binding, but regulators and insurers are expected to comply*

Risk margin

"The calculation of the risk margin in Solvency II is sensitive to current interest rates. This sensitivity is likely to have significant absolute and hedging costs for firms when there are short term variations in the risk-free rate. Such a degree of volatility is likely to be undesirable from a microprudential and macroprudential point of view, because it promotes procyclical investment behaviour."

Bank of England Response to the European Commission

Call for Evidence on the EU Regulatory

Framework for Financial Services, January 2016

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