Simmons & Simmons

Brexit - deal or no deal?

Implications of a ‘no-deal’ Brexit for the insurance industry

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ABI

"It is unacceptable not to have a Brexit deal at the point at which we leave in 2019.

As the chancellor said in the Mansion House speech, the Brexit process has to be delivered in a way that enables business to operate, and our customers not to suffer any unnecessary detriment.

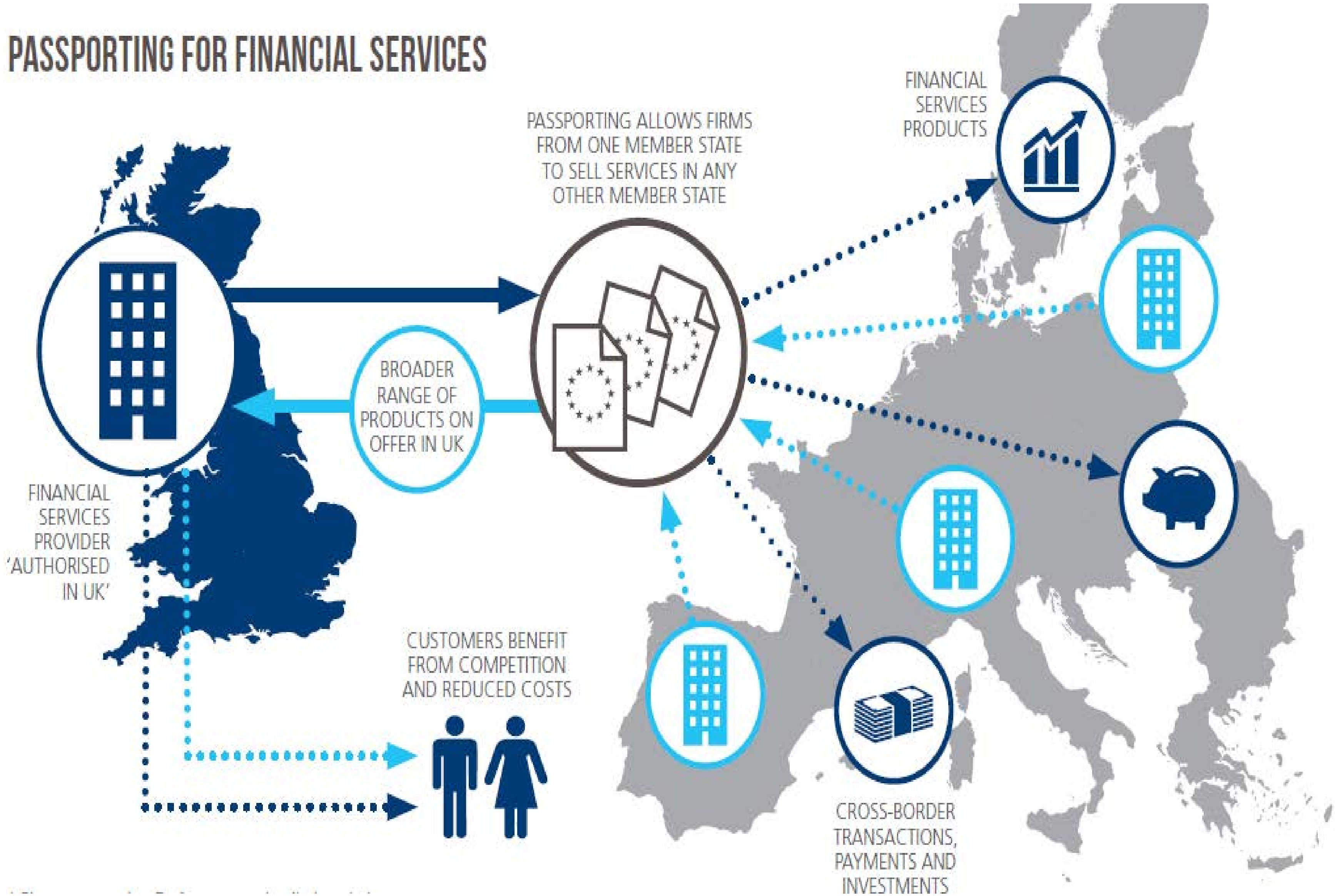
To meet our clients' needs as an industry and ensure full compliance with the law, the government has to deliver an orderly withdrawal, a stable transition and a sensible and mutually beneficial future trading relationship."

Huw Evans
Director General
Association of British Insurers

27 June 2017

Key questions

- How will UK firms continue to access the EU27 and EEA markets? How will EU and EEA firms continue to access the UK market?
- What will be the impact on third-country firms accessing either the UK or EU/EEA market?
- How will Lloyd's of London be affected?
- Will we see an increase in M&A activity and consolidation in the insurance market?
- What will happen to Part VII transfers of business?
- What impact will there be on insurance regulation, if any?
- Can insurers expect the UK to be granted Solvency II equivalency?
- Will or should choice of law and jurisdiction be impacted?
- Will insurers' investments be impacted?
- Will the UK still be able to attract top talent?



Source: TheCityUK

Passporting

Regulatory implications

- Question whether a true single market in financial services actually exists under the current passporting regime

However, what happens when the passport is no longer available:

- Group restructuring to provide for a presence in both the EEA and UK:
  - Use or establish a group subsidiary in an EEA country other than UK (with its own regulatory capital) through which to operate any passporting rights
  - Use or establish (as a third country insurer or reinsurer) an EEA branch which would need to obtain local authorisation
  - Provide services into the EEA via a third country insurer
  - Redomicile, for instance under the European Company/Societes Europaea regime
  - Merge or acquire in order to achieve one of the above
- Potentially considerable operating, regulatory and tax costs as insurers adapt, though many already have continental European subsidiaries or separate groups
- Potential for spate of new M&A to address loss of passporting rights and achieve further diversification in terms of geographical reach

Passporting

Grandfathering of existing insurance contracts

- TF50 position paper on "Essential Principles on Citizens' Rights published on 12 June 2017 which states that:
  - *"the Withdrawal Agreement should protect the rights of EU27 citizens, UK nationals and their family members who, at date of entry of the Withdrawal Agreement, have enjoyed rights relating to free movement under Union law, as well as rights which are in the process of being obtained and the rights the enjoyment of which will intervene at a later date [for example pension rights]."*

- Following which on 11 September 2017, Insurance Europe published a position paper stating that the above principle should include (re)insurers' ability to service existing contracts issued by virtue of the passport regime before Brexit

- Insurance Europe calls on the UK and the EU to reach agreement on the grandfathering of existing insurance and reinsurance contracts to ensure the rights and obligations of the parties continue

- Insurance Europe states that transitional arrangements will not resolve the problem given a transitional period is likely to be for a maximum of 2 or 3 years, while contractual obligations under passported contracts (especially life and pensions) could run for decades

- Without any resolution the transfer of individual contracts or books of policies will be inevitable and there is a risk these transfers may not be authorised in time for Brexit

Passporting

Impact on Lloyd's of London

- For a Lloyd's syndicate, there is a unique position
- EU Directives currently allow syndicates to enjoy passporting within the EU under the Lloyd's collective authorisation
- Only 4% of Lloyd's global GWP at risk; EEA only accounts for 11% of Lloyd's total GWP and almost ½ of this is reinsurance
- Specialist insurance industry not likely to be affected
- Canada and the U.S. together account for 47% of Lloyd's total GWP
- Lloyd's is setting up an EU subsidiary in Brussels in order to take advantage of the passport to operate across the EU post-Brexit
- Notwithstanding the EU passport, Lloyd's insurers and reinsurers are (under the Lloyd's umbrella) licensed and authorised to trade in 80+ countries and may still underwrite, even where no licence or authorisation may exist and where they would do so on a non-admitted basis, in 200+ countries worldwide

Where are insurers going?

- A common feature of many groups' Brexit plans is the need to establish an EEA insurer to underwrite European policies post-Brexit and to which the European business of the UK insurer can be transferred pre-Brexit

- Insurers' current plans:
  - **Luxembourg:** RSA, CNA Hardy, AIG, Hiscox
  - **Dublin:** Chaucer; AXA and Beazley are upgrading existing operations; L&G setting up new base for its investment management division
  - **Brussels:** Lloyd's, QBE
  - **Germany:** Markel

"Empty shells or letter boxes are not acceptable. Sound supervision demands appropriate location of management and key functions including sound outsourcing and reinsurance policies".

Gabriel Bernardino
EIOPA Chairman
30 May 2017

Transfers of business

Likely to become more difficult?

- Transfers of business under Part VII FSMA have, to date, been used for many different purposes by (re)insurers
  - Divesting a non-core business
  - Achieve cost savings and capital releases (particularly important in light of SII)
  - In advance of a scheme of arrangement
  - Linked to M&A
  - In restructuring overseas businesses
- Currently, passporting rights ensure mutual recognition of transfers as between the UK and other EEA states. With a loss of passporting rights comes a loss of mutual recognition of business transfers
- Insurers may then have to make multiple applications to different EEA state courts or regulators making the whole process much more complex – perhaps impossible
- Or Insurers transfer UK business to European subsidiary and use the EU passport after doing so
- PRA will lose its leading role in the Part VII process as far as fellow regulators are concerned

Potential regulatory change

Divergence or equivalence?

- Current EU financial services regulation derives from or is consistent with PRA initiatives
  - Solvency II – UK's legacy to the rest of Europe?
  - Insurance Distribution Directive

- UK to achieve 'equivalence' under Solvency II or diverge from EU?
  - UK regime currently identical to EU regime (given implementation of Solvency II)
  - U.S. surprisingly deemed 'equivalent'
  - Solvency II does not provide 'passport'
  - Revision or reduction in regulation to drive increased business

- PRA and FCA to focus, not solely on European regulators, but on global approaches
  - Andrew Bailey, CEO of the FCA, stated in a recent speech at Thomson Reuters:
    - *"We have built effective structures around supervisory colleges in the EU and globally, and **at the FCA we have over 100 memorandums of understanding with other regulators around the world**."*

- IAIS focussed on 'global regulation' based on risk management ,IFRS and accounting convergence.

"If there is a commitment on all sides that the UK and the EU maintains substantially equivalent regulatory arrangements in future, it will not be necessary to restrict open markets and free trade in financial services and therefore not necessary to limit the freedom of firms on location.

And therefore, I see no reason why we should sacrifice open financial markets and free trade, as an inevitable response to Brexit."

Andrew Bailey
CEO of the Financial Conduct Authority
6 July 2017

FINANCIAL CONDUCT AUTHORITY

Choice of Law and jurisdiction

So what next?

- Jurisdictional issues
  - Brussels I Recast (“BR1”) and the Lugano Treaty 2007 (“Lugano 2007”) will cease to apply unless negotiations to make them do so take place;
  - Hague Convention on Choice of Court Agreements 2005 will cease to apply unless UK becomes a signatory in its own right
- Applicable law issues
  - Rome I (contractual obligations) and Rome II (non-contractual obligations) will cease to apply as they are governed by EU Regulations
- Arbitration
  - Little expected to change – the English Arbitration Act 1996 is a domestic Act and not based on any EU Regulation or Directive
  - May be positive – unless we continue to adhere to BR1 or Lugano 2007; the “anti-suit” injunction, prohibited by *West Tankers*, may be resuscitated
- Service of proceedings – need for an agent for service process clause?
- Enforcement of judgments – uncertainty and inconsistency?

Investments

- Uncertainty = market disruption but wider volatility across markets (including fixed income, equities and currencies) has the potential to impact solvency capital ratios – is this all caused by Brexit? Wider geo-political issues, yield is down generally
- Impact on insurers' capital with the potential to lead to a reduction in investment capacity and prudential provisions
- Potential downgrading of insurers' credit ratings
- Investment activities currently subject to EU legislation: Solvency II; MiFID II, MAR
- Firms which may not be reliant on the EU passport for their (re)insurance business may find that they rely on the passport to conduct investment business but wider issues in Europe for insurers' in-house investment firms
- Potential reduction in investment from U.S. and China using UK as a platform access the EU/EEA however UK FDI inflows soared to £197bn in 2016 (up from £33bn the previous year) according to OECD and additional investments, including by McLaren, Boeing, Toyota and Qatar have been announced at the start of 2017
- Loss of jobs and reduction of talent pool in UK?

The post-Brexit future for London's insurance market

- Solvency II equivalence likely
- Immediate divergence from EU regulation unlikely
- Potential for increase in M&A activity and consolidation of market but insurers largely global
- Continue to have leading specialist markets: marine, energy, cyber
- Lloyd's network of international licences will continue to provide unparalleled access to global insurance markets
- Renewed focus on relationship with the U.S.
- UK insurers will look to develop and grow their business in new markets – i.e. Africa, Latin America and Asia – this is already a focus
- Increase in innovation – London Market Group looking to make London more attractive by pushing for automation of some of the more manual processes

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