

David Kendall

The Impact of Brexit on Insurance and Reinsurance

As matters currently stand, the United Kingdom will cease to be a member of the European Union on 29 March 2019. What impact is that likely to have on insurance and reinsurance?

Although the EU Commission and the UK Government are negotiating the terms of the UK's exit and what may apply thereafter, given the apparent lack of progress, the breadth and depth of ground to be covered, and the lack of time within which to achieve agreement, the most likely outcome is the UK's departure from the EU with no agreement in place, at least as regards access of UK insurers to the EU and vice versa. This article will consider the position on that assumption.

On Brexit, the UK will lose the benefits of membership of the EU and will become a Third Country for the purposes of EU law and regulation. The UK Parliament will have passed legislation by which the existing body of EU law will be transposed into UK law. The UK's relationship with the European Economic Area (the EU member states together with Iceland, Liechtenstein and Norway) will be governed by World Trade Organisation rules. The General Agreement on Trade in Services of the WTO contains "most favoured nation" provisions which require (with some exceptions) WTO member countries not to discriminate between services and service providers from other WTO members. This may impact any fixes which the UK and EU may consider essential to address the immediate problems described below.

UK insurers may currently underwrite business in the other EEA Member States directly or through a branch or other establishment in reliance on their UK regulatory authorisation. Likewise, EEA insurers can "passport" into the UK based on their home state regulators' authorisation. This will come to an end on 29 March 2019. At that point, UK insurers will not be authorised to carry on insurance business in EEA member states and EEA insurers will not be able to carry on business in the UK without authorisations from the host state regulators. Until such time as authorisations are obtained (and it is

doubtful whether the host state regulator can grant authorisations while the insurer is operating under home state regulation prior to Brexit), it will be illegal for the insurer to continue to collect premium and pay claims in the host state.

Existing book of EU business: Temporary authorisations or "grandfathering"

While many UK insurers are establishing subsidiaries in the EU to enable them to continue to carry on insurance business in the EU after Brexit, unless the existing book of EU business is transferred into the new subsidiary before Brexit by means of a Part VII transfer, the restrictions on carrying out contracts of insurance entered into by the UK insurer in the EU, including the payment of claims, will apply.² Insurance Europe has recommended "grandfathering" as the best solution by which insurers would be allowed to service existing contracts under EU law,³ although its proposal is limited to contracts insuring, or reinsuring, EEA citizens or entities.

Careful drafting should avoid this issue, but simply agreeing that the non-authorised insurer can carry on performing its contracts in these circumstances may open the door to insurers in WTO member states seeking the same concession. According to a report in the Financial Times on 29 September 2017, the UK's Financial Conduct Authority is considering temporary authorisations rather than "grandfathering", which it did not think was likely to be appropriate.

New EU-subsidaries: properly staffed and not mere brass plates

The European Securities and Markets Authority has made it clear in an opinion published in May 2017 that existing authorisations of UK-based entities will not be automatically recognised in the EU after Brexit. The opinion also encourages EU regulators to scrutinise applications for authorisation to ensure that the subsidiaries being established in anticipation of Brexit are properly staffed, retain risk and are not mere brass plates. This will put pressure on those businesses who envisaged out-sour-

cing operational functions back to the UK, or using the subsidiaries as fronting insurers to be reinsured back to the UK.

Even if not allowed to "passport" into the EEA, it has been suggested that the position of UK insurers and reinsurers will be ameliorated by the EU's recognition that the UK regulatory regime is equivalent to that of the EU, particularly as on Brexit, both regimes will be based on Solvency II. Even if the EU moves quickly to grant equivalence recognition, the benefits are limited:

- Reinsurance contracts underwritten by an entity in an equivalent jurisdiction must be given the same treatment as if underwritten by an EU insurer;⁴
- Where a Solvency II group includes a Third Country insurer in an equivalent jurisdiction, the group may apply the rules applicable in the Third Country for the purposes of group capital calculations;⁵
- Where a Solvency II group is headquartered in the Third Country, the EU regulators must rely on the supervision of the group by the Third Country regulator.⁶

The EU's equivalence decision is discretionary and may be rescinded at any time. To maintain equivalence recognition, the UK will probably need to track changes in the Solvency II regime as they are made by the EU, which may be politically unacceptable.

Of immediate concern to UK reinsurers of US risks is whether they will be able to take advantage of the recent EU/US covered agreement after Brexit. As the UK will not be in a position to negotiate its own covered agreement with the US until after Brexit, there may be a period in which the US collateral requirements removed by the EU/US covered agreement will have to be reinstated for UK reinsurers once the UK becomes a Third Country after Brexit.

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Uncertain position of intermediaries

UK insurance intermediaries will also need to consider their position post-Brexit. Authorisation of an intermediary by the Financial Conduct Authority under the Insurance Mediation Directive (soon to be the Insurance Distribution Directive) will cease on Brexit to allow the intermediary to “passport” into EU Member States. Fresh authorisations will be needed for branches in those Member States, or a subsidiary will have to be incorporated and authorised in a Member State to enable the intermediary to carry on its business in the EU post-Brexit.

London market insurers will have to be wary about the extent to which they can underwrite EEA risks broked to them in the UK. While UK regulatory supervision is likely to continue to apply by reference to the place where the insurer is carrying on insurance business, the regulation of Third Country insurers in the EEA varies from country to country with some requiring regulatory approval where the risk to be underwritten is situated in the country even if the insurer has no presence there.

Where the insurance intermediary acts as a managing general agent or coverholder

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for UK insurers in the EU, care will have to be taken to ensure that the underwriting and claims handling activities of the intermediary do not require its principal insurers to be authorised in the EU Member States in which the intermediary operates. The EU rules as to when an insurer has an establishment in a Member State through an intermediary are subject to differing interpretations in Member States. It is an area that would benefit from some clarification under UK law, so perhaps a post-Brexit opportunity beckons.

Insurers and reinsurers rely on data to evaluate and underwrite risks. The receipt of personal data from EU insureds post-Brexit will depend on the speed at which the EU is willing to decide that the UK’s data protection regime is considered “adequate” by the EU Commission in accordance with the General Data Protection Regulation. It may not be possible to achieve adequacy immediately post-Brexit because of the legal process involved which may not start until after Brexit.

More legal complications

Other complications that will arise for UK insurers and reinsurers post-Brexit include the fact that the Rome I Regulation concerning the law applicable to insurance contracts and the Recast Brussels Regulation concerning jurisdiction and the recognition and enforcement of judgments will cease to apply on Brexit. While the regulations will be transposed into UK law by means of the European Union (Withdrawal) Bill, how the courts of EU Member States will apply the regulations when dealing with litigation involving UK insurers may vary from country to country. This creates uncertainties for underwriters and policyholders alike.

If the UK is to exit the EU pursuant to a deal, it will be necessary to negotiate a complex trade agreement in record time, even if all parties are willing to extend the period in which an agreement is to be concluded by the two or three year transition period being suggested in various quarters of the UK government. Such an agreement will be unprecedented in that under the current arrangements, there are no tariff barriers and the restrictions on the free movement of goods, services, capital and people are relatively minor. The agreement will entail the raising of tariffs and barriers which will affect different industries in different ways.

A vast project generating great uncertainty

There is little evidence that industries in the UK and EU have begun the process of considering how those trade-offs are to be achieved or the level of disruption that each will have to assimilate. Since free trade agreements rarely involve freedom of access for financial services, the likelihood remains that “passporting” for UK and EU insurers into each other’s markets will become a thing of the past. The impact on the UK insurance industry remains to be seen.

Brexit is a vast project generating great uncertainty. It will present pitfalls and opportunities for those in the insurance industry many of which remain to be identified.

¹ *The European Union (Withdrawal) Bill was introduced in Parliament on 13 July 2017*

² *It is uncertain whether in this scenario, the insured or reinsured would be entitled to enforce its rights under a UK contract: see para 14-042 Colinvaux’s Law of Insurance*

³ *Insurance Europe position paper in the context of Brexit issued on 11 September 2017*

⁴ *Article 172 Solvency II Directive*

⁵ *Article 227 Solvency II Directive*

⁶ *Article 260 Solvency II Directive*