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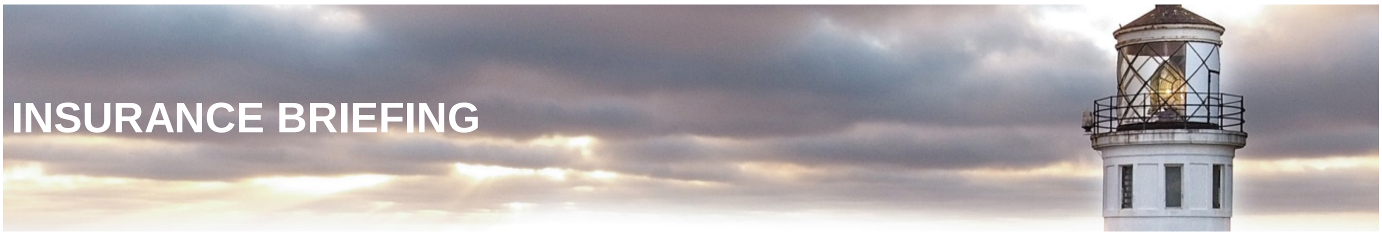

BREXIT: IMPACT ON EEA INSURERS AND NON-EEA HEADQUARTERED GROUPS

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Introduction

Following the UK referendum on EU membership, businesses have no alternative but to prepare for the UK's exit from the EU. The precise timing of the UK's withdrawal remains unclear and even greater uncertainty surrounds the relationship between the UK and the EU that will follow. Nonetheless, there is broad agreement that it is not too early for firms to look at the implications of the vote and to understand the range of actions that could be taken to mitigate the risks to their business.

For UK insurers and reinsurers, withdrawal from the EU does not of itself mean that they will be excluded from doing business in EEA states. Their ability to access EEA insurance markets will depend in part on rules applying under the Solvency II Directive ("Solvency II") to so-called "third country" insurers and reinsurers. Otherwise, and subject to the outcome of negotiations regarding the new relationship between the UK and the EU, it will be a matter for individual states to determine the basis on which UK firms can access their insurance markets. These issues were discussed in our recent briefing "Access to the single market" – an explanation for the (re)insurance sector.

By the same token, it seems inconceivable that EEA insurers will be denied access to the UK insurance market post-exit. The precise terms on which they will be able to conduct cross-border activities will depend on the outcome of negotiations between the UK and the EU and on requirements for reciprocity agreed in that context. As the UK will no longer be bound to follow Solvency II, in the absence of exit negotiations providing a specific regime, the UK can decide which rules should apply. Its ability to change the current regime will in practice be limited if the UK wishes to establish its status as an "equivalent" jurisdiction.

We consider some of the issues for EEA insurers below. We also look at issues raised by the UK's exit from the EU for non-EEA headquartered groups that currently passport into the EEA from a UK subsidiary. In this note, the terms "insurers" and "insurance companies" should be read as including both insurance and reinsurance companies, unless otherwise specified. The term "pure reinsurer" refers to a firm that only carries on reinsurance business. References to "EU" and "EEA" should be taken to exclude the UK.

The Future UK/EU Relationship

As stated above, rules on access to overseas markets applying to UK and EEA insurers post-exit will depend on the outcome of negotiations. There are a number of possible structural outcomes, apart from any bilateral arrangements arising from the secession negotiations. The main options which have precedents in the EU's relations with other countries are:

- EEA (European Economic Area)
- EFTA (European Free Trade Association)
- EU/UK FTA (Free Trade Agreement)
- Customs Union
- EU/UK CETA (Comprehensive Economic and Trade Agreement)
- WTO (World Trade Organisation)

The diagram below illustrates the implications of each approach for the UK. More detailed discussion of these options and the challenges they present can be found in our Brexit Legal Guide.

	CONTRIBUTE TO EU BUDGET	FREE MOVEMENT OF PEOPLE	SCHENGEN OPEN BORDERS	PARTICIPATE IN EU LAW MAKING	EU MARKET ACCESS – GOODS	EU MARKET ACCESS – SERVICES	FINANCIAL SERVICES "PASSPORTS"	TRADE TREATIES WITH THIRD COUNTRIES
EU (UK terms)	Yes	Yes	No	Yes	Yes	Yes	Yes	Yes
EEA (Norway)	Yes	Yes	Yes	No	Yes	Yes	Yes	Some possibly
FTA (Switzerland)	Yes	Yes	Yes	No	Yes	Limited extent	No	No
Customs Union (Turkey)	No	No	No	No	Yes	No	No	No
CETA (Canadian)	No	No	No	No	Largely Tariff Free	No	No	No
WTO (Most of rest of world)	No	No	No	No	Most Favoured Nation Tariffs	No	No	No

EEA Insurers – Accessing the UK Insurance Market

There are three approaches that an EEA insurer may adopt to carry on cross-border business into the UK once the UK leaves the EU. The preferred approach is likely to depend on a combination of the nature of the business being written and on arrangements agreed between the UK and the EU for continued access to the UK market:

- Carry on business through a UK branch
- Provide insurance services into the UK without establishing a permanent presence here
- Write business through a newly established (or existing) UK subsidiary

EEA insurer establishing UK branch

Without the help of a crystal ball, it is impossible to know what rules will govern the establishment of a UK branch by EEA insurers post-exit. Current UK requirements applying to UK branches of non-EEA insurers meet the requirements of Articles 162-175, Solvency II. The same rules would apply, absent further change to the UK regime, to UK branches of EEA insurers once they can no longer passport into the UK (see discussion of these requirements in our recent publication *"Access to the single market" – an explanation for the (re)insurance sector)*.

Once the UK leaves the EU it will no longer be bound by Solvency II. The UK could, in theory at least, make it considerably harder for an EEA insurer to establish a UK branch. In practice, this is unlikely to happen. In the context of broader Brexit negotiations, the UK government can be expected to seek to maintain, as close as is possible, access to EU markets for UK businesses. If anything, to secure the best reciprocal access of UK insurers into the EEA, the UK might be expected to take a more lenient approach to the authorisation and supervision of UK branches of EEA insurers than it takes to branches of non-EEA insurers.

EEA insurer providing services into the UK

The position for EEA insurers wishing to provide insurance into the UK on a services basis (ie without having a presence in the UK) is also unclear. The UK has historically taken the view that authorisation is only needed by third country insurers, which will include EEA insurers post-Brexit, if they are actually carrying on insurance business here. In other words, they must be effecting or carrying out contracts of insurance by way of business "in the UK" under the Financial Services and Markets Act 2000 ("FSMA"). If an overseas insurer's activities are not caught by this definition, it does not require authorisation for its activities. It can access the UK market on what is commonly described as a "non-admitted" basis.

There is a significant amount of case law that considers when an insurer's activities in the UK are sufficient for it to be caught by FSMA. Particular points arising from the case law are as follows:

- Whether or not an insurer is carrying on insurance business in the UK comes down to a question of fact and the specifics of any particular arrangement.
- The greater a firm's connection with the UK, the more likely it is to be carrying on activities in the UK.
- As a general rule, any presence in the UK, whether this is a branch, an office or establishment, a permanent employee or an agent or representative is a strong indication that the activity is carried on in the UK.
- However, an overseas insurer's lack of a presence in the UK will not, of itself, prevent the insurance activity from being carried on in the UK.
- The location of the risk is a factor in ascertaining where the insurance activity is carried on, although for overseas insurers may not necessarily be determinative.

One such case is Secretary of State for Trade and Industry v Great Western Assurance Co SA [1997] 2 BCLC 685, which confirmed that the general approach of the Insurance Companies Act 1982 (pre-FSMA legislation[1]) did not prohibit the placing of UK risks with insurers who were not authorised in the UK. It did, however, prohibit the effecting and carrying out of any insurance business in the UK by such insurers. In other words, insuring risks based in the UK is not the same as carrying on insurance business in the UK and the location of the risk is not necessarily the place in which the insurance business activity is carried on.

Absent any change to FSMA (other than changes that inevitably flow from the loss of passporting rights), the rules described above should apply following Brexit to EEA insurers in the same way as they apply today to, for example, US insurers.

Recent indications are, however, that some EU Member States, including Germany, are moving towards heavier regulation of non-admitted business than has been the case to date. In addition, in July 2015 the EU Commission ("Commission") expressed[2] the view that "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". This is the Commission's view of the effect of Article 162, Solvency II which is grandfathered almost word for word from Solvency I.

If the Commission's view is adopted by EEA states, it will affect UK insurers' ability post-exit to write new business in EEA states on a non-admitted basis, ie without establishing a branch. If this turns out to be the case, the UK may decide to take the same approach, for reasons of reciprocity, to EEA insurers wishing to access the UK market. We do not envisage that the same change would be extended to non-EEA insurers as it would have significant implications for those insurers that currently access the UK market on a non-admitted basis.

EEA insurer establishing UK subsidiary

If the passport becomes unavailable for activities carried on in the UK by an EEA insurer, the preferred solution may be to conduct those activities through a UK subsidiary. That subsidiary would be subject to UK rules on the authorisation and supervision of a UK insurer which may, or may not, be the same as they are today. This will depend on whether the UK decides to keep its current, Solvency II, regime or whether it decides to adopt a new approach. In practice, it seems likely that the UK regime will be broadly the same as under Solvency II, albeit that over time some changes may be made.

A number of issues are raised by this option for EEA-headquartered groups. These include the following:

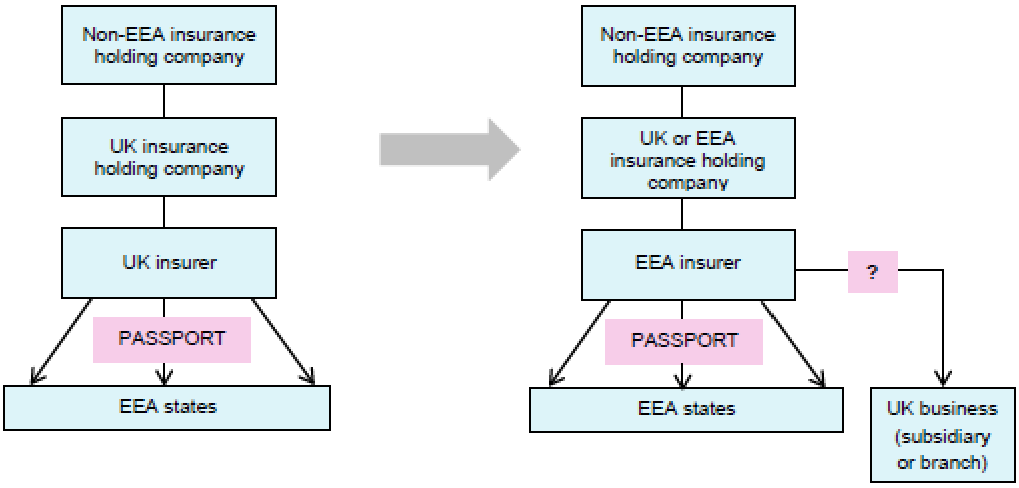
- To obtain authorisation in the UK, the UK subsidiary will be expected to have its head office here (assuming the rules stay the same as they are now). This may mean moving aspects of the business and its governance to the UK that have previously been located elsewhere.
- Any proposed restructuring of the group needs to take full account of the time that it would take to obtain a new authorisation in the UK and to allow for the transfer of business to reflect the new corporate structure. This may be difficult when so much uncertainty remains about the future of the UK's relationship with the EU.
- The creation of an additional insurer within the group is likely to bring with it increased capital costs for the group as well as the additional administrative costs associated with UK supervision of the UK subsidiary.
- UK subsidiaries within EEA-headquartered groups would need to be brought into account for group capital purposes on a Solvency II basis (unless the UK has been assessed as equivalent for the purposes of Article 227, Solvency II, in which case UK rules would apply). In practice, even if the UK is not given equivalence status, it is doubtful whether this would have much significance while the UK regime reflects Solvency II standards because there would be little difference in the calculation. Nonetheless, affected EEA firms may wish to lobby for the UK to be given equivalence status from the date of its exit from the EU.

Non-EEA Headquartered Groups – Accessing EEA Markets

For a group that is headquartered outside the EEA, loss of the ability to passport into the EEA may make the UK less attractive as a "hub" for its European business. Groups in this position may prefer to transfer their sub-group headquarters to a different EEA jurisdiction and then consider the various options described above for the conduct of their UK business. How attractive this option is would depend, amongst other things, on how far across the EEA the group's business extends. For example, it is difficult to see what benefits, if any, would accrue to a group that currently only has operations in the UK and one other EEA state. The position may be very different, however, for a group that passports its business from the UK throughout the EEA.

Otherwise, many of the issues for non-EEA headquartered groups with a sub-group operating from the UK are the same as for UK-headquartered groups. For example, where a group or sub-group decides to move its headquarters out of the UK, it may prefer to retain the bulk of its operations in the UK on an outsourced basis. The extent to which this can be achieved will depend upon the regulatory regime in both the UK and in the jurisdiction to which it is moving, and in particular any local substance requirements in that jurisdiction. If other aspects of the UK regulatory regime diverge from the EEA, particularly in relation to the protection of personal data, this may also have a bearing on the extent to which such an outsourcing model is viable.

Typically, this type of sub-group will be headed by an insurance holding company, not an authorised insurer (see diagram below), which in principle makes the transfer of the sub-group (including relevant insurance subsidiaries) to another jurisdiction relatively easy to achieve.



However, a simple transfer of shares in the insurance holding company to a new insurance holding company established in an EEA state does not overcome the loss of passporting rights by the UK insurer.

To achieve this, it would be necessary to transfer some or all of the business of the UK insurer to an EEA insurer (any UK business may be retained in the UK carrier). Whilst some operational functions may need to be transferred to the EEA, the headquarters of the holding company need not necessarily also be transferred out of the UK. An alternative approach to restructuring the group may be to convert the UK insurer to a Societas Europaea ("SE") so that it can subsequently redomicile (ie transfer its registered office, its assets, rights and obligations and the identity of its "home state" for regulatory purposes) anywhere within the EEA.

In deciding on a new jurisdiction for the headquarters of the business, important factors will include:

- willingness of key staff to move to the new jurisdiction and post-exit rules determining their ability to work there;
- availability of local expertise (both in terms of staff for the insurance business and for service providers to support the business) in sufficient numbers;
- possible language barriers;
- availability of expertise and capacity within the regulator in the new jurisdiction; and
- quality and extent of office accommodation.

The group may also wish to consider the likely approach of its new group supervisor to supervision of the group outside the EEA. Solvency II confers considerable discretion on group supervisors of non-EEA headquartered groups to decide on the appropriate level of supervision and practice may vary across EEA states (see Article 262, which allows the group supervisor to supervise the group by way of "other methods" instead of applying Solvency II standards to the entire group). Should a group supervisor wish to take a particularly intrusive approach to supervision of the group at worldwide level, this may cause the group to look again at its options for relocation.

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