HERBERT SMITH FREEHILLS

Insurance

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In common with other financial services firms, UK (re)insurers and (re) insurance intermediaries currently benefit from passporting rights set out in the Solvency II Directive ("**Solvency II**") and the Insurance Distribution Directive ("**IDD**"). Withdrawal from the EU does not of itself mean that they will no longer be able to do business in EEA States. What it does mean is that they will not be able to carry on insurance activities on an EEA-wide basis as a matter of right, flowing from the UK's membership of the EU.

To mitigate the impact of this change, and absent a deal between the UK and EU preserving passporting rights (which is not expected even if the UK leaves the EU on terms agreed by Theresa May's Government), a number of UK (re)insurers and intermediaries have established, or are establishing, an EEA subsidiary to act as a 'hub' for their group's EEA business with a single EEA authorisation.

Other approaches available to ensure that cross-border business can continue post-Brexit include establishing authorised branches in relevant EEA jurisdictions, as provided for in Solvency II. A key disadvantage with this approach, however, is that a UK (re) insurer or intermediary will not be able to rely on a branch authorisation obtained in one EEA state to conduct insurance activities in other EEA states; passporting rights do not attach to a branch authorisation.

The loss of passporting rights is equally relevant to the cross-border activities of (re) insurers and intermediaries coming from the EEA into the UK – those that are carrying on insurance business in the UK will require authorisation from the Prudential Regulation Authority ("**PRA**") or the Financial Conduct Authority ("**FCA**") (as the case may be) for those activities.

Deal or no deal?

In November 2018, the UK Government agreed terms with the European Council for the UK's withdrawal from the EU, as set out in the Withdrawal Agreement endorsed by the EU Council on 25 November 2018. The accompanying Political Declaration sets out a framework for the future relationship of the EU and the UK.

The Withdrawal Agreement provides for a transitional period which is currently set to run from the date of the UK's withdrawal from the

The section is part of our Brexit Legal Guide.

No deal

- If the Withdrawal Agreement and the Political Declaration, or a revised version, are not approved by 31 October 2019 (or by such other date as may in due course be agreed with the EU), the UK will cease to be an EU state on that date without any transitional (or implementation) period
- The body of EU law in force on that date will be imported into UK law (with necessary amendments) under the European Union (Withdrawal) Act 2018 and secondary legislation made under it called 'retained EU law'
- A lot of the secondary legislation has already been made, including regulations to create "onshored" versions of the regulatory regimes established by Solvency II and the IDD
- The onshoring legislation includes various consequential amendments to financial services legislation, including the Financial Services and

EU until 31 December 2020 (but which could be extended to the end of 2022). During that period, both (re)insurers and (re)insurance intermediaries would continue to benefit from the passporting rights that they currently hold, but ultimately stand to lose irrespective of whether the UK leaves with a deal.

Once the transitional period had been agreed, the PRA and FCA clarified their approach to Brexit, encouraging (re)insurers and intermediaries to assume that they would continue to benefit from passporting rights until the end of 2020. Whilst this was a welcome development, firms recognised that the transitional period would not be guaranteed until all terms of the Withdrawal Agreement had been approved, including by the UK Parliament. UK firms with significant EEA interests continued to plan, therefore, on the assumption that the UK would leave the EU without a deal and that they would lose their passporting rights immediately on exit.

The UK Parliament subsequently blocked approval of the Withdrawal Agreement three times under Prime Minister Theresa May. The next Prime Minister, Boris Johnson, has stated that the current deal will not be approved without the removal of the "Irish backstop". As a result, UK (and EU) no-deal contingency planning remains highly relevant as the current, 31 October 2019 deadline approaches. For firms, there is also little option but to continue planning for a no deal Brexit.

Even if it were to go through, the non-binding Political Declaration that accompanies the Withdrawal Agreement contains little of substance about the future conduct of cross-border financial services beyond the parties aspiring to complete equivalence assessments with respect to each other before the end of June 2020. Whilst a finding of equivalence would have some value for certain UK (re)insurers, those benefits fall considerably short of offsetting the loss of the passport. In the case of intermediaries, "equivalence" has no meaning whatsoever under the IDD. It is not clear, therefore, that a finding of equivalence would assist those wishing to distribute insurance cross-border.

UK approach to no deal

If the UK leaves the EU on 31 October 2019 (or such other date as may be agreed with the EU) without agreeing terms for its withdrawal, the UK Government has agreed to establish a 'temporary permissions' regime ("**TPR**"), which will enable firms coming into the UK from other EEA jurisdictions to carry on business here while they obtain the PRA and FCA authorisations needed for those activities.

The introduction of the TPR means that incoming EEA (re)insurers and (re)insurance intermediaries do not need to apply for, and obtain, full authorisation for their UK operations by the date on which the UK leaves. If the UK leaves the EU on that date without a transitional period (ie without a deal), these firms will be able to rely on the TPR whilst they apply for the authorisations they need to continue their business long term.

Firms can take advantage of the TPR through a simple notification process. The FCA has currently extended the period for notification until 31 October 2019. The PRA notification window closed in April 2019. After exit day, firms who have entered the TPR will be allocated a "landing slot" within which they must submit an application for full UK authorisation.

The UK is also introducing a Financial Services Contracts Regime ("**FSCR**") to ensure that those EEA firms that do not enter the TPR, and those that exit the TPR without UK authorisation, are able to wind down their UK regulated activities in an orderly manner.

The position is considerably more difficult for UK firms as the UK's jurisdiction only extends to activities carried on here. If there is no transitional period, the TPR is only effective for EEA firms operating in the UK and it can do nothing to help UK firms wishing to conduct activities in other jurisdictions without the benefit of passporting rights.

For UK insurers with policyholders in EEA States, there is a particular risk that they will no longer be licensed to deliver services in those countries unless they go through the onerous process of establishing an authorised branch in each country (or unless the policies have been transferred by the time of Brexit to an EEA carrier). Not doing this may leave insurers unable to pay out on claims.

Despite many calls for this issue to be dealt with as a matter of priority during exit negotiations, it was not covered by the Withdrawal Agreement or by the terms of the Political Declaration.

EIOPA recommendations

Recommendations published by the European Insurance and Occupational Pensions Authority ("**EIOPA**") in February 2019 provided some, very late, guidance in relation to cross-border insurance activities. In particular, EIOPA emphasised the importance of safeguarding policyholders in the event of a no deal Brexit.

Market Act 2000 and related secondary legislation

- The PRA and FCA have published various briefing materials, including detailed policy statements, changes to rules applying in a no-deal scenario and details of the TPR and FSCR. These are available on the FCA and Bank of England/PRA Brexit landing pages
- Subject to certain exceptions, the FCA, Bank of England and PRA will exercise temporary transitional powers to enable firms to adjust to changes made as a result of onshoring. In most cases, firms will have until 31 December 2020 to ensure they meet any changes to their UK regulatory obligations connected with Brexit
- EIOPA recommendations published in February 2019 provide some guidance on the conduct of cross-border insurance activities by UK (re) insurers and intermediaries post Brexit

Deal

- If approved by the UK Parliament, the Withdrawal Agreement, or some version of it, will set out arrangements for the UK's withdrawal from the EU
- A transitional period will follow the date of the UK's EU exit up until at least the end of 2020, possibly the end of 2021 or 2022
- During this period, EU law will continue to apply in and to the UK and the UK will continue to trade as part of the Single Market
- Means:
  - Passporting rights between the UK and the EEA for (re) insurers and (re)insurance intermediaries will continue during the transitional period

In some areas, EIOPA provided explicit guidance on the approach it expected individual states to take. For example, and unsurprisingly, EIOPA stated that UK insurers should not be allowed to write new contracts in the EEA post-Brexit without having an EEA authorisation. In other areas, EIOPA took a "softer" approach, leaving it up to individual states to decide how to respond. Some of the key points arising from EIOPA's recommendations are set out below. For additional detail, see our blog post dated 21 February 2019 here.

Insurers

Key points for insurers arising from the recommendations included the following in relation to so-called "legacy business":

- EEA States were encouraged to apply a mechanism for the run-off of EEA business by UK insurers who lose their authorisation or to require those insurers to take immediate steps to become authorised. A number of jurisdictions, including France, Germany, Ireland and Spain have introduced measures to deal with the run-off of insurance contracts. Each state's approach is, however, different.
- EEA States were also encouraged to recognise that, whilst UK insurers should not be able to write new business (including any renewals, extension or increase of cover) without obtaining a suitable EEA authorisation, policyholders who exercise an option or right in an existing policy to start taking their pension should not be prejudiced.
- Where a policyholder is habitually resident in the UK at the date of entering into a life insurance contract but moves to the EEA afterwards, national authorities should take this into account in its supervisory review. Implicit in this recommendation, the UK insurer should be enabled to meet its obligations to policyholders under this category of contract without the need for an EEA authorisation (or without having to transfer the policy to an EEA carrier). It also suggests that the servicing of policies that were written before Brexit on a cross-border basis would require an EEA authorisation. In practice, it seems that most policies in this second category have been, or are being, transferred to an EEA insurer in the lead up to Brexit.
- National authorities should take the same approach to those classes of non-life business where the risk is treated by Solvency II as situated in the state of an individual's habitual residence (or the state of a legal person's establishment). Making an exception for cover relating to buildings, buildings and their contents and to vehicles, as EIOPA does, is consistent with Solvency II rules on the location of risk. It is also consistent with the view that the habitual residence of an individual is only relevant at the outset of a contract. EIOPA recognises, however, that individual states may take different views on this.

Intermediaries

The difficulties raised by Brexit for intermediaries have received considerably less attention from regulators to date than those of insurers. EIOPA's recommendation on distribution activities emphasises the importance of consistency in regulation across the EU and in the uniform application of the IDD. At the same time, it recognises explicitly the ability of individual states to take their own view on how intermediaries should be regulated, provided that the minimum standards of the IDD are met.

Planning for Brexit has been hindered by competing provisions in the IDD determining its jurisdictional scope, including uncertainty about how far the prohibition in Article 16 (restricting reliance by EEA insurers and intermediaries on non-EEA brokers) extends. The following remarks made by EIOPA are relevant:

- EIOPA recommends that national regulators consider "distribution activities which target EU27 policyholders or EU27 risks". This is different to the language in IDD, which references the "taking up and pursuit" of distribution activities in the EEA.
- National regulators should also "assess any distribution model against the definition of distribution activity ... in the IDD".

EIOPA's view seems to be that IDD requirements should be applied to all distribution activities that involve EEA policyholders and EEA risks. This would be a broader test of what amounts to "distribution activities" than regulators in some jurisdictions are thought to apply. The UK, for example, applies a test of where the relevant activities are carried on and not one of where the risk or client is located.

FCA guidance published shortly after EIOPA's recommendations were released adds little, if anything, to what was said by EIOPA. For brokers, in particular, the FCA acknowledged that this is "a complex area" and advised firms to contact local EEA regulators and seek legal advice. Further commentary on the FCA guidance can also be found on our Brexit blog here.

- Directly applicable EU legislation, such as the Solvency II Delegated Regulation, will continue to apply in the UK until the end of that period
- There will not be any immediate Brexit-driven changes to financial services laws (eg the Financial Services and Markets Act 2000) or the FCA and PRA rules
- Issues relating to equivalence may be dealt with under any future relationship agreement between the UK and the EU27
- No-deal contingency measures implemented by the UK Government and regulators (including the TPR and the FSCR) will not be activated upon Brexit
- The non-binding Political Declaration will provide a framework for the future relationship between the UK and the EU. There is nothing in the present version that indicates there would be a return to passporting. The establishment of equivalence declarations seems likely, in the event of a deal, but these would not provide the comprehensive passporting rights available to insurers established in member states of the EEA

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GEOFFREY MADDOCK

Post-Brexit UK regime

UK regulation of (re)insurers post-Brexit seems likely to follow Solvency II closely. The argument for further change (beyond the various changes that have already been introduced by the PRA) once the UK is no longer constrained by Solvency II is that reducing the burdens imposed on UK-headquartered groups would enable them to become more competitive outside the EEA. In practice, there are other considerations:

- The PRA was behind much of the content of Solvency II and is unlikely to want to depart radically from its standards.
- Many UK insurance companies have also said that they would not welcome the upheaval that would accompany a significant rewriting of the rules.
- For the UK to be assessed as 'equivalent', it will undoubtedly need to follow Solvency II closely.

Equally, post-Brexit UK regulation of (re) insurance intermediaries can be expected to remain much the same as today. This is in large part because the IDD establishes minimum standards only for the conduct of insurance distribution business and the UK therefore already has greater freedom than under Solvency II to establish its own rules.

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