HERBERT SMITH FREEHILLS

BREXIT - EIOPA PUBLISHES OPINION ON LEGACY INSURANCE BUSINESS

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Legal Briefings – By **Alison Matthews**

An opinion published by EIOPA yesterday raises concerns for UK insurers who have policyholders in EEA states other than the UK. This will include, for example, every life company with annuitants living in an EEA state*, perhaps because they moved from the UK on retirement.

Insurers have been aware of issues raised by Brexit for legacy contracts written (or performed) cross-border since the UK referendum on EU membership (see, for example, our client briefing issued in July 2016). However, it has been widely hoped, to now at least, that a sensible compromise would be reached by the UK government and EU authorities to ensure that firms do not need to embark on expensive and time-consuming processes to avoid detriment to policyholders once the UK leaves the EU. Such a compromise currently appears less likely.

In summary, EIOPA warns that UK insurers are unlikely to be able to meet their obligations to EEA policyholders post-Brexit unless they mitigate the anticipated loss of passporting rights that will come with leaving the single market. It argues that, once UK firms can no longer rely on the passport, they lose their authorisation to carry out insurance activities in other Member States with regard to cross-border contracts. "This includes insurance portfolios in run-off."

It follows that UK insurers will "usually" not be able to pay claims or to fulfil other contractual obligations under pre-existing cross-border policies, despite the fact that those policies will

continue to be valid as a matter of contract. The term "usually" has presumably been introduced here because it is a matter of local law whether authorisation is needed to pay claims into a particular jurisdiction. The UK, for example, recognises the ability of non-EEA firms to operate in the UK market on a "non-admitted" basis provided that their activities fall below the threshold set by FSMA for carrying on insurance business in the UK.

EIOPA suggests that mitigating actions available to firms include establishing an EEA subsidiary to act as a "hub" for their EEA business. Capital inefficiencies may, however, make this an unattractive proposition, particularly for insurers who are not writing new business outside the UK and have no intention of doing so post-Brexit.

An alternative solution would be for the UK insurer to obtain authorisation for a third country branch in the relevant EEA jurisdiction(s). This approach carries with it the significant disadvantage, however, that a third country branch (including an EEA branch of a UK insurer post-Brexit) has no passporting rights. Separately authorised branches would be needed, therefore, in every jurisdiction where there are policyholders.

A third solution offered by EIOPA is for the UK insurer to transfer its affected policies to an EEA insurer, which would require a Part VII FSMA transfer. This is, however, a long and expensive process which requires a suitable transferee company to be found or, in some cases, established. A recent warning issued by the PRA to the UK courts also suggests that there are concerns about capacity in the UK to deal with all of the Part VII transfers that would be needed to resolve issues with legacy business.

In any case, a Part VII transfer does not necessarily provide a perfect solution. For example, what happens when a policyholder who is receiving payments from a UK insurer moves out of the UK after the Part VII transfer has taken place? On the one hand, the UK insurer will usually not be authorised under the relevant EEA state's law to carry on paying claims to the policyholder; on the other hand, it remains contractually obliged to do so. EIOPA has not addressed this issue.

PRA and FCA guidance on Part VII transfers also lacks clarity in this area and could be revisited in support of UK firms. For example, a more flexible approach could be taken to novations of small numbers of policies in circumstances where a UK insurer has very few policyholders in other EEA states and is able to agree with them to move their policies otherwise than under a Part VII process (at the moment, the guidance suggests that a Part VII transfer might still be needed). The UK regulators' approach to the loss of FSCS protection on transfers might also be reviewed in the context of transfers of policies by UK insurers in response to Brexit concerns.

Creative solutions may also need to be considered. For example, a UK insurance group with an existing, or already planned, EEA subsidiary could decide to offer to receive transfers of all of the affected contracts from all affected UK insurers. The liability (or almost all of the liability) could then be reinsured back to the relevant carrier. We have not considered competition issues at this stage, but such a "multiple transferor, single transferee" Part VII scheme could in theory be accomplished under a single court process with the costs shared appropriately.

Equally, EEA insurers who currently passport on a branch or services basis into the UK need to consider how they are going to continue servicing their UK policyholders post-Brexit. They are also caught by EIOPA's announcement. The UK government has confirmed (see our blog post dated 20 December 2017) that it will do what is needed to ensure that contractual obligations can be met post-Brexit. However, the PRA has stated that it expects EEA insurers who currently passport into the UK to apply for authorisation to the extent necessary to carry on those activities. This will include EEA insurers who have ongoing payment obligations to policyholders in the UK, at least to the extent that their activities constitute "carrying out contracts of insurance in the UK" for the purposes of the FSMA regime. The approach taken by the UK to "non-admitted" business differs from that in most, if not all, other EEA states. This means that some EEA insurers who currently only do services business in the UK may be able to satisfy themselves that their activities fall outside the UK regime post-Brexit and can therefore avoid the need for authorisation here.

EIOPA's comments confirm that UK insurers can no longer assume that a sensible outcome, that is in the interests of policyholders and insurers throughout the EEA, will be reached in Brexit negotiations on legacy contracts. This is despite the fact that the continued enforceability of in-force contracts is arguably just as much a matter of protecting citizens' interests as other issues discussed in the first stage of the Brexit negotiations.

Considerable resource will, therefore, need to be devoted to resolving this issue, even by those insurers who only have a handful of policyholders outside the UK. These projects need to begin now to the extent that they have not already been started. EIOPA has advised supervisory authorities that they need to be monitoring insurers' contingency plans carefully, including whether implementation of those plans is "realistic".

*The legal test of whether an insurer is carrying on services business is determined, for life, by the Member State of the commitment (usually, where a policyholder is habitually resident) and, for non-life, by where the risk is situated. This will usually mean that cross-border services are provided where a life company makes payments to annuitants living in another EEA state, although the legal test is one of habitual residence, as opposed to current residence.

KEY CONTACTS

If you have any questions, or would like to know how this might affect your business, phone, or email these key contacts.



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