EIOPA ISSUES BREXIT ADVICE - SOME GOOD NEWS FOR UK INSURERS AND INTERMEDIARIES?

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Legal Briefings – By **Geoffrey Maddock, Barnaby Hinnigan, Alison Matthews, Grant Murtagh**

Recommendations issued on Tuesday by EIOPA emphasise the importance of safeguarding policyholders in the event of a "no deal" Brexit. Encouragement given to EEA states to help UK insurers meet their obligations to EEA policyholders is particularly welcome.

In some areas, EIOPA has provided explicit guidance on the approach it expects individual states to take. For example, it is clear (and unsurprising) that UK insurers should not be allowed to write new contracts in the EEA without authorisation. In other areas, EIOPA has taken a "softer" approach. Examples include that regulators:

- should apply "a legal framework or mechanism to facilitate the orderly run-off" of business which becomes unauthorised as a consequence of Brexit; and
- should not prejudice policyholders who have "an option or right in an existing insurance contract to realise their pension benefits".

Overall, EIOPA's announcement attempts to strike an appropriate balance, reflecting the considerable lobbying efforts by UK and EU27 trade bodies. Its acknowledgement of individual state discretion in a number of key areas does, however, still leave uncertainty for UK firms planning for 29 March 2019. There is also nothing in EIOPA's recommendations that could not have been said many months (or even years) ago. It is a pity that politics have prevented earlier publication of these recommendations, leaving industry to spend many millions on unnecessary legal advice and other contingency planning.

EIOPA has given national regulators 2 months to say if they comply with each recommendation, or explain non-compliance.

INSURERS

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

- EEA states are 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 have already started to adopt measures to deal with the run-off of insurance contracts. For example, France has recently introduced legislation confirming that non-EEA insurers will need an authorisation to write new contracts (including renewals) post Brexit. This prohibition will not apply, however, to the payment of premiums that a policyholder is required to pay under a contract concluded before Brexit. Nor will it affect the payment of claims by a UK insurer under policies existing at the time of Brexit.

- EEA states are 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, we believe that most policies in this second category 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 – hence its recommendation that they "take into account" the fact that the UK insurer did not write this business cross-border.

- Portfolio transfers from UK insurers to an EEA carrier that have been started, but not completed, by the date of the UK's withdrawal from the EU should be allowed to complete. This reflects the commitment already made by the UK government to UK insurers. Whilst this is helpful for policies governed by English law, insurers do need to remember that as a matter of law the ability to transfer policies governed by EEA law ends with Brexit. It will be up to individual states, therefore, whether to recognise the transfer under the relevant local law.

Other aspects of the recommendations include the following:

- **Authorisation of EEA branches** – Where a UK insurer decides to set up an EEA branch under Article 162 of the Solvency II Directive, EIOPA recommends that account is taken of the fact that the UK insurer was Solvency II compliant immediately before Brexit. It also suggests that national authorities might accelerate the authorisation of a branch provided that they restrict its authorisation to running off legacy business.

- **Communication** – EEA states are reminded to tell UK insurers with cross-border business in their state of the need to inform policyholders how their rights and obligations are affected by Brexit. In addition, national authorities are themselves told that they should make public the legal framework applicable to the cross-border business of UK insurers post-Brexit.

INTERMEDIARIES

The difficulties raised by Brexit for intermediaries have received considerably less attention from regulators to date than those of insurers. EIOPA's recommendation (Number 9) on distribution activities emphasises the importance of consistency in regulation across the EU and in the uniform application of the Insurance Distribution Directive (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. How national regulators respond to this point will be of interest to UK brokers.

The language in Recommendation 9 seems to be aimed at making the wholesale (ie sub-broking) model difficult to implement, as it seems to be calling on regulators to take a broad view of what amounts to the taking up and pursuit of distribution activities in the EEA. Quite how difficult depends on whether one reads the word "target" as having a broad or a narrow meaning. Despite the ambiguity, our understanding is that the recommendation is intended to be negative in respect of the wholesale-broking model. There are, however, circumstances in which it seems inconceivable that an EEA intermediary should not be able to call on advice from an intermediary outside the EEA, including where specialist knowledge is needed that simply does not exist in the local market or where a risk is located outside the EEA and its placement on behalf of an EEA policyholder requires specialist knowledge of that local market.

EIOPA's recommendations also provide implicit support for the "branch back" model, while emphasising the importance of ensuring that EEA-authorised intermediaries have sufficient substance in their home state. What that means in each case will reflect the nature, scale and complexity of the business. In practice, the local presence required will be a matter for the home state supervisor, who will need to be satisfied that it can exercise effective supervision.

Finally, Recommendation 2 is helpful to insurers with run-off books. While insurance intermediaries are not specifically referenced in this context, EIOPA's recognition of the need for an orderly run-off might provide insurance intermediaries with comfort as they look to transition their business to post-Brexit models.

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