BREXIT

A&L Goodbody

What next for your insurance business?

Background

Despite the fact that the UK referendum held on 23 June 2016 resulted in a majority voting in favour of the UK leaving the EU, there is still a lot of uncertainty about the practical legal consequences of the vote. It is likely that legal uncertainty will continue for a considerable period of time.

It is in the interests of the UK and the EU that a sensible post-exit relationship is negotiated between the UK and the EU to ensure appropriate access for UK (re) insurers to the EU and vice versa. However, as the outcome of any such negotiations is uncertain, it is sensible to plan for a worst case scenario and to ensure that should negotiations not proceed as would be hoped, appropriate contingencies are in place to allow UK (re)insurers have access to EU markets and vice versa.

The UK is still a part of the EU notwithstanding the vote on 23 June and the formal process for the withdrawal of the UK from the EU has yet to commence. Indeed, the UK government has indicated that Article 50 will not be triggered in this calendar year. It is unclear whether an act of parliament is required to start this process.

The exit of a member state from the EU is dealt with in Article 50 of the Treaty on European Union (**TEU**). This article has never been invoked. This is the mechanism that the UK would follow to formally leave the EU.

As regards timing, Article 50(3) of the Treaty provides that:

> "The Treaty shall cease to apply to the State in question from the date of entry into force of the withdrawal agreement or, failing that, two years after the notification referred to in [Article 50(2)], unless the European Council, in agreement with the member state concerned, unanimously decides to extend this period".

It may take significantly longer than two years to negotiate the terms of exit and the UK/EU post-Brexit relationship. For example, the Comprehensive Economic and Trade Agreement between the EU and Canada took 7 years to negotiate and has yet to be ratified. Any agreement would have to cover multiple areas of trade and commerce of which financial services would only be one. Insurance would only be one part of the financial services agenda.

So what now?

The nature of the relationship that the UK ultimately negotiates with the EU will determine whether "passporting" will be available between the UK and EU Member States and other issues concerning engagement by UK (re)insurers with EU customers and vice versa.

It is possible that a future regime could retain passporting rights between the UK and the EU, in which case UK and European Economic Area (**EEA**) (re)insurers would be able to continue to maintain branches and provide services in each other's territories on the basis of their "home" authorisation.

Another possible outcome of the negotiations is that the UK and EU establish a "grandfathering" arrangement, whereby cross-border trading arrangements that were in place on or before the date of the arrangement could continue in operation for a period of time after that date.

Any contingency plan should, however, include a scenario where the UK will not benefit from passporting rights. In the event that passporting rights do not continue between the UK and EU, EU (re)insurers will need to consider the scope of their access to the UK and vice versa, including whether new establishments and authorisations are required. (Re)insurers will need to consider the local requirements that would apply in order to continue doing business in or into the countries concerned, if insurance passporting rights do not continue.

We set out in this paper some key practical issues from an (re)insurers's perspective:

UK (re)insurer currently operating in Ireland

1. On a Freedom of Establishment basis through an Irish branch

In order to continue to do business in Ireland through an Irish branch, the (re)insurer may need to:

a) Obtain a local authorisation for that branch (that would not benefit from EU passporting rights); or

b) Establish a subsidiary (with its own regulatory capital) in Ireland or another EU or EEA Member State, if established in another EU or EEA Member State; that subsidiary would be entitled to establish a branch in Ireland and to passport throughout the EU/EEA [1]; or

c) Acquire an existing EU/EEA (rew)insurer to do so.

2. On a Freedom of Services basis from the UK

In order to continue to do business in Ireland the (re)insurer may need to:

a) Establish a locally-authorised branch (that would not benefit from EU passporting rights); or

b) Establish an insurance subsidiary incorporated and authorised in Ireland or in another EU/EEA Member State.

Irish (re)insurer currently operating in the UK

1. On a Freedom of Establishment basis through a UK branch

In order to continue to do business in the UK, the (re)insurer may need to:

a) Obtain UK authorisation for the UK branch; or

b) establish a UK subsidiary (with its own regulatory capital) [2]; or

c) acquire an existing UK (re)insurer.

2. On a Freedom of Services basis from Ireland

In order to continue to do business in the UK the (re)insurer may need to:

a) Establish a UK authorised branch; or

b) Establish a UK authorised subsidiary; or

c) Acquire an existing UK (re)insurer.

Alternative options

The (re)insurer will have to assess the viability of the various options considered above, as well as alternative options such as fronting arrangements with local third party insurers or converting the (re)insurer to a European company or "SE", and moving its jurisdiction of incorporation to facilitate continuing to conduct business. This would require re-authorisation of the (re)insurer in the jurisdiction to which it moves. For example, a UK (re)insurer with significant EU/EEA business might move its incorporation and become re-authorised in an EU/EEA Member State but also apply for authorisation of a UK branch.

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[1] An EU/EEA authorisation of a branch of a non-EU/EEA (re)insurer is confined to the Member State giving the authorisation. Therefore, such branches would not have EU/EEA passporting rights. A UK (re)insurer carrying on business in a number of EU/EEA Member States may, therefore, prefer to establish or acquire an EU/EEA authorised (re)insurer or discontinue their EU/EEA business as an alternative to establishing multiple authorised branches in EU/EEA Member States. Depending on the outcome of the UK's exit negotiations, it may also be necessary for the UK (re)insurer to transfer its existing (run off) EU business to an EU/EEA subsidiary prior to the UK's exit. There is no obligation on EU Member States to authorise third country branches and vice versa.

[2] As above, it may be necessary for the Irish (re)insurer to transfer its UK business to that UK subsidiary prior to the UK's exit.

Discontinuation of business

If the (re)insurer decides not to continue conducting some or all of its business, options for discontinuance include:

a) Running off the existing business, assuming that this is permitted under the terms of the UK's exit from the EU, perhaps coupled with a sale of "renewal rights" to a third party;

b) Transfer of existing EU or UK portfolios to a third party; or

c) If the book of business is small (and is not a compulsory class of insurance) incentivising policyholders to commute.

Use of intra-EU mechanisms for recognition of cross-border mergers and portfolio transfers

It would be prudent for (re)insurers wishing to use mechanisms such as portfolio transfers, cross border mergers or a European company to do so while the UK remains an EU Member State.

Regulatory considerations

In the event that changes to the UK's relationship with the EU significantly impact the insurance industry, it is foreseeable that both the UK and EU/EEA member state regulators will be busy dealing with a multitude of various requests for authorisation and other approvals. Therefore, it would be prudent to factor this into timing where the approval of any member state regulator is required.

Conclusion

Brexit will lead to a period of uncertainty. The optimal outcome would be a negotiated exit for the UK that preserves market access privileges for all. It is only when the final details of any such agreement(s) between the UK and the EU are known that (re) insurers will be able to make fully informed choices. Therefore, in the interim, it would be prudent to plan for worst case scenarios to ensure that contingency plans are in place should negotiations between the UK and the EU not proceed as hoped.

For (re)insurers that might be interested in the Irish authorisation application process, we have set out below a high level overview and an indication of applicable ongoing requirements.

Life, Non-Life and Reinsurance Undertakings seeking authorisation from the Central Bank of Ireland (CBI)

Establishment

Application process includes:

- Preliminary meeting with CBI after applicant has a good understanding of the process and requirements. A Preliminary meeting will also enable the applicant to explain regulated business and to understand CBI's likely focus during the application process.
- Application that adheres to specific CBI requirements as set out in relevant CBI checklists (Life Insurance applications, Non-Life Insurance applications, Reinsurance applications).
- Broadly, the principal areas considered by CBI in evaluating applications include legal and ownership structure, soundness of application, business plan, systems of governance, risk management and 'fitness and probity' of key personnel. CBI also focuses on financial information and capital.
- CBI states that following receipt of completed application, expected timeline to authorisation is 3 months but that applications can take up to 6 months. We consider 5-6 months to be a realistic period, allowing for questions back and forth between the applicant and CBI.

Establishment involves:

- Applicants demonstrating that the 'heart and mind' i.e. the decision making organs and key functions of the institution are located in Ireland.
- CBI expects full authority and effective control of the business, including decision making at Board and Committee level, to take place in Ireland. Examples of key functions in this regard are Compliance, Internal Audit, Risk Management and Actuarial, although this list is not prescriptive.
- Use of service companies and outsourcing is permitted but control and responsibility sits with (re)insurer's board of directowrs.

On-going requirements

Prudential requirements include:

- Capital requirements, systems of governance requirements and qualifying shareholder approval requirements, in accordance with Solvency II (transposed into Irish law by the European Communities (Insurance and Reinsurance) Regulations 2015) and related CBI requirements, information notes and guidelines.
- Corporate Governance Code for Insurance Undertakings imposing minimum standards and additional requirements for 'high impact' insurance undertakings.
- 'Fitness and Probity' regime for employees fulfilling 'controlled functions' including 'pre-approval' regime for specified senior employees.
- Outsourcing permitted in accordance with Solvency II.
- Quarterly and annual reporting requirements and CBI funding levies.

Conduct requirements include:

- Consumer Protection Code covering various topics including provision of information, KYC, product suitability and post sales information requirements, complaints and record keeping (Irish market only).
- Minimum Competency Code requires firms to ensure that individuals who provide advice on or sell retail financial products or undertake specified activities acquire certain competencies (Irish market only).

A&L GOODBODY INSURANCE BREXIT TEAM

James Grennan
Head of Insurance & Reinsurance
T: +353 1 649 2318
E: jgrennan@algoodbody.com

Laura Mulleady
Partner, Insurance & Reinsurance
T: +353 1 649 2609
E: lmulleady@algoodbody.com

Sinead Lynch
Partner, Insurance & Reinsurance
T: +353 1 649 2453
E: smlynch@algoodbody.com

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