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HARDER TIMES: The effects of Brexit on UK firms' insurance distribution in the EU

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While the post-Brexit regulatory landscape in the EU would rightly be seen overall as a more challenging and stringent one in which to operate – where, in general, a business is either authorised under, or in breach of, local law – it may be that individual member states have made or come to make discrete provision for activities in particular circumstances that could enable a more nuanced approach, as the UK has done.

LESA

LESA is a mitigant for the effects of Brexit. It is a Belgian insurance company which can therefore utilise 'passporting' – the relatively simple administrative process whereby a business can establish a branch or, with even less formality, conduct services in one or more other EU member states.

Lloyd's of London is of course a marketplace which involves multiple phases or types of insurance intermediation and distribution including in respect of:

- 'members', which carry the risk via operating collectives or units known as 'syndicates';
- 'managing agents', which manage the syndicates' business activities;
- 'coverholders', which conduct business with delegation from or via managing agents; and
- brokers, which represent the insureds.

The article considers below the extent to which some of those expecting to deal with or via LESA might have taken the view that the benefits or substance of passporting would continue to apply for businesses which are authorised in the UK but not in the EU.

EIOPA AND THE INITIAL RESPONSE TO POST-BREXIT PLANS

The European Insurance and Occupational Pensions Authority ("EIOPA") describes itself as *"an independent advisory body to the European Commission, the European Parliament and the Council of the European Union". Its aims include: "To ensure strong, effective and consistent regulation and supervision, taking account of the interests of all member states and the different nature of financial institutions ..."*

In a 2017 opinion, EIOPA explained that, in the light of the UK's notification in March 2017 of its intention to withdraw from the EU, *"EIOPA has carried out on-site visits to certain supervisory authorities and discussed the processes and resources in place to deal with potential*

relocations [of "UK-based undertakings"" (ie insurers)] into the EU.

The opinion reminded EU member state supervisors to *"scrutinise whether governance arrangements in the undertaking seeking authorisation ensure effective decision-taking and risk management ... Undertakings should not display the characteristics of an empty shell".*

The opinion also considered the prospect of partial relocations, or relocations with a re-export of operational capabilities to, or their retention within, the UK. The opinion's text on this issue is significant, as the opinion noted the *"the UK as the most important financial centre in the EU contributing by 24% of EU28 to the total financial and insurance activities in 2015"*, and thus implicitly recognised how the power and expertise within insurance groups created a 'gravitational pull' towards the UK, which needed to be counteracted:

> *"Relocating and new entities may seek to limit the impact of relocation through an extensive use of outsourcing of functions or activities. Such an approach cannot be allowed to deplete the corporate substance of the EU entities with repercussions on the adequacy of their management ...*
>
> *... outsourcing of critical or important functions (or key functions) or activities is permitted for EU undertakings or branches provided that ... the outsourcing does not*
>
> - *materially impair the quality of the system of governance,*
> - *unduly increase operational risk,*
> - *impair the ability of supervisors to monitor compliance or*
> - *undermine continuous and satisfactory service to policyholders.*
>
> *... The undertaking should retain sufficient expertise and resources to monitor and manage its risks [and] ... be in a position to resume direct control over an outsourced activity ...*
>
> *... activities which are critical or important in an insurance undertaking, such as the design and pricing of insurance products, investment of assets or portfolio management, claims handling, compliance function, internal audit, accounting, risk management or actuarial support, provision of data storage or the provision of on-going systems maintenance or support should require particular attention by the supervisor when being notified of the intended outsourcing ..."*

EIOPA's position gives clear guidance on the nature and scale of activity which needs to be conducted substantively from an EU location for an EU-authorised insurance business.

RECOMMENDATION 9

EIOPA's 2017 opinion was followed in 2019 by its further 'Recommendations', including 'Recommendation 9':

> *"Competent authorities should ensure that UK intermediaries and entities which intend to continue or commence distribution activities to EU27 policyholders and for EU27 risks after the UK's withdrawal are established and registered in the EU27 in line with the relevant provisions of the IDD* [(Insurance Distribution Directive)].
>
> *Competent authorities should ensure that [such] intermediaries ... demonstrate an appropriate level of corporate substance, proportionate to the nature, scale and complexity of their business.* [emphasis added].
>
> *These intermediaries should not display the characteristics of an empty shell"* – the repetition of this phrase from the 2017 opinion shows the importance of the point.

THE EFFECT ON LESA

In early 2020 Lloyd's put a news item on its website which explained that from 1st October 2020 LESA would *"not be accepting new business"* from brokers and coverholders that are not authorised within the EU and which are looking to intermediate insurance policies *"where the risk in question is for a policyholder in an EU member state and where the risk location for that risk is within the EU."*

The implication of the above change in position is that intermediaries had been placing EU-based risks with LESA on the basis that the Belgian authorisation for the effecting of the insurance policy would mean any intermediation activity prior to that effecting would necessarily be legitimate, whether or not any intermediary involved was EU-authorised.

As per EIOPA's Recommendation 9, this was not the view taken by the Belgian regulator.

Interestingly, a Lloyd's Newsletter said that in response to the imminent loss of passporting rights *"many UK intermediaries have established an EU-authorised intermediary with a UK branch, also known as 'reverse branching'."* The newsletter did not however say whether that 'reverse-branching' itself was compliant with relevant laws within the EU, and met the standards advocated in EIOPA's 2017 and 2019 papers for the operational effectiveness of EU subsidiaries.

THE UK – OUTLIER OR FRONT-RUNNER?

In substance, the UK's position is no different from that advocated for the EU by EIOPA: becoming and remaining authorised involves a comprehensive, if not exhaustive, approach. A key difference is the length of period of adjustment that the UK has allowed for insurance firms that had previously passported into the UK: the 'Temporary Permissions Regime' currently provides for such firms to attain authorisation by the end of 2023.

Implementing the IDD did not fundamentally change member states' existing laws as to what constitutes an activity that requires authorisation, nor as to certain derogations from such requirements. The UK continues to apply the 'appointed representative' exemption (see s 39 Financial Services and Markets Act 2000 – "FSMA") to the general requirement of authorisation, and has a number of discrete exclusions from such requirement, notably the 'overseas person' exclusion (see the [FSMA] Regulated Activities Order 2001 / 544 article 72) for persons conducting business with or through authorised or exempt persons – which the FCA has noted may be of particular benefit to insurance distributors (Perimeter Guidance manual, para 5.12.10 G).

It may be that effective exploration and ongoing monitoring of member states' local laws could reveal some nuances that could make cross-border business less onerous for UK firms – an assumption that 'nothing can be done' might prove to be as mistaken as an assumption that 'nothing has changed'.

This article was first published by Law360

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