Brexit – what now for insurers?

Re:think

EUROPE | UK January 2017

In the aftermath of the Brexit vote, attention is now beginning to focus on the legislative impact on insurers given the extent of EU law in the insurance sector. The government have stated repeatedly that they will not give a running commentary on negotiations. And EU institutions and other member state governments are steadfastly refusing to engage until Article 50 has been triggered. In the midst of this uncertainty, we can still sift out what we do know and what this might mean for the industry.

REGULATION AND DIRECTIVES

The best place to start is to understand how EU legislation manifests itself in the UK and the difference between EU Regulations and EU Directives.

An EU Regulation is a binding legislative act that is applied in its entirety across the EU. The European Communities act in the UK means that such regulations become law in the UK automatically as soon as the regulation is enacted in the EU.

An EU Directive is an EU legislative act that sets out a goal that all EU countries must achieve. However, it is up to the individual countries to devise their own laws on how to reach these goals. For example, the EU Gender Directive was transposed into UK law through the Equality Act while the Solvency II Directive was transposed through a mixture of an EU Regulation, a UK statutory instrument and changes to the PRA handbook rather than any primary legislation. Significantly, for insurers, this means that the legal requirement for gender equality in pricing will remain in place after Brexit unless subsequent legislation is put in place to remove it.

> **"…this means that the legal requirement for gender equality in pricing will remain in place after Brexit…"**

In summary then, if the UK left the EU, the laws emanating from Directives would remain in place because they are enshrined in UK law. However, the same could not be said for EU regulations. But this picture changed with news of the Great Repeal Bill.

> **"…if the UK left the EU, the laws emanating from Directives would remain in place because they are enshrined in UK law."**

THE GREAT REPEAL BILL

At the Conservative party conference in Birmingham on 2nd October, Prime Minister, Theresa May, announced the Great Repeal Bill. The 1972 European Communities Act would be repealed and this would remove the priority of EU law over UK law.

However the Great Repeal Bill is a bit of a misnomer in that on the day of exit, far from repealing EU law, it will transpose the entirety of EU Regulation into UK law so that it can be scrutinised, amended or repealed later.

> **"…the Great Repeal Bill is a bit of a misnomer…"**

This is necessary for continuity reasons but also because otherwise, there could be large gaps in legislation. In effect, it buys time for government to go through the legislation after Brexit and decide which bits to keep.

What adds to the uncertainty is the timing of regulations that are in the pipeline. For example PRIIPS (Packaged Retail and Insurance-based Investment Products) and GDPR (General Data Protection Regulation) are both due to land while the UK is still in the EU so should form part of UK law under the Great Repeal Bill, but what if they are delayed (PRIIPS has already been delayed) until after the UK has left the EU?

There are some pieces of legislation that require special attention. For example, the Financial Services and Markets Act 2000 gives passporting rights to EU and EEA countries, so unless the government have negotiated passporting arrangements for the financial sector, this would need to be changed. Otherwise it would unintentionally give away passporting rights to EU and EEA countries.

Another question that arises is what will the status of EIOPA be? Many rules reference EIOPA but there is currently no corresponding UK organisation which performs the same role. Would it be in the spirit of Brexit to give an EU supranational body a say in UK regulations?

"…what will the status of EIOPA be?"

PASSPORTING

So what about passporting? The issue is not such a big one for life insurance compared to other financial sectors. Member states each have their own conduct regulations and as a result there is no true single market for life insurance. In addition, many UK life companies do not operate in continental Europe and others who do have separate legal entities in each country.

"…there is no true single market for life insurance."

However, some pan-European groups and reinsurers will be affected. One question is how group supervision will operate if a UK group is headquartered outside the EU.

EQUIVALENCE

If the UK is deemed to be equivalent for the purposes of group supervision then EU supervisors can rely on UK supervision for UK headquartered pan-European groups. However, if the UK is deemed not to be equivalent then there will be dual supervision of the UK group between the PRA and the relevant EU supervisor.

Other areas of equivalence are for the solvency calculation and for reinsurance. Solvency calculation equivalence will mean that UK rules can be used for UK subsidiaries of EU groups for calculating solvency capital. Reinsurance equivalence means that reinsurers are treated the same way as EU reinsurers although currently most member states have no restrictions on non-EU reinsurance.

Given that on day 1 of withdrawal from the EU, the UK will have the same rules as the EU, it would be difficult for the EU to justify not granting equivalence in all three areas as is already the case for Bermuda. However, there are no hard and fast rules for assessing equivalence and the granting of equivalence is not automatic. What's more, if in the future, UK rules diverge from those in the EU, it is possible that equivalence could be withdrawn.

"…if in the future, UK rules diverge from those in the EU, it is possible that equivalence could be withdrawn."

TREASURY SELECT COMMITTEE INQUIRY

Meanwhile the Treasury Select Committee have launched an inquiry into Solvency II. In the words of Andrew Tyrie, the chair of the committee:-

"Brexit provides an opportunity for the UK to assume greater control of insurance regulation.

The Solvency II Directive came into force in January, only after a heap of concerns had been expressed about it. Among its manifest shortcomings was the failure to secure value for money over its implementation.

The Treasury Committee will now take a look at the Brexit inheritance on insurance to see what improvements can be made in the interests of the consumer."

One of the things the inquiry will do is to consider the options for the UK insurance industry that are created by the decision to leave the EU. One option is to revert to the regime immediately prior to Solvency II. Another is to retain Solvency II as at the data of Brexit but not incorporate any subsequent changes.

"One option is to revert to the regime immediately prior to Solvency II."

Having undergone the expense of Solvency II, few in the industry would welcome any wholesale change. But there may be opportunities to simplify and refine some aspects. The PRA have long held the view that the cost of capital to calculate the risk margin should be interest rate sensitive.

Another objective of the inquiry is to assess whether SII makes us less competitive in the global arena.

> **"…there may be opportunities to simplify and refine some aspects."**

POST BREXIT

In the absence of the harmonising regulation of the EU, the PRA and the FCA will end up with greater powers. This could be seen as a good thing or a bad thing. On the one hand, without the harmonising influence of the EU, regulators could shape the rules more closely to the requirements of the UK. On the other hand, there is a possibility that this could lead to a higher regulatory standard.

All in all, we should not assume that EU law disappears overnight on Brexit given that it will be transposed into UK law. But what happens after that remains to be seen.

Pacific Life Re works with clients in Europe, Asia, Australia and North America to manage their mortality, longevity and morbidity risk. We have built a strong, experienced team with a reputation for technical expertise, responsiveness, innovation and excellence in service delivery to our clients.

Pacific Life Re Limited is a wholly-owned subsidiary of Pacific LifeCorp, the parent company of Pacific Life Insurance Company.

For more information about Pacific Life Re please visit our website www.pacificlifere.com or follow us on LinkedIn.

FOR MORE INFORMATION, PLEASE CONTACT:

JAMES TAIT
Head of Protection
Pacific Life Re | Europe
T: +44 (0)20 7709 1814
E: james.tait@pacificlifere.com

Pacific Life Re Limited
Tower Bridge House
St. Katharine's Way
London
E1W 1BA
T +44 (0)20 7709 1700