Reaching a Consensus on (Re)insurance

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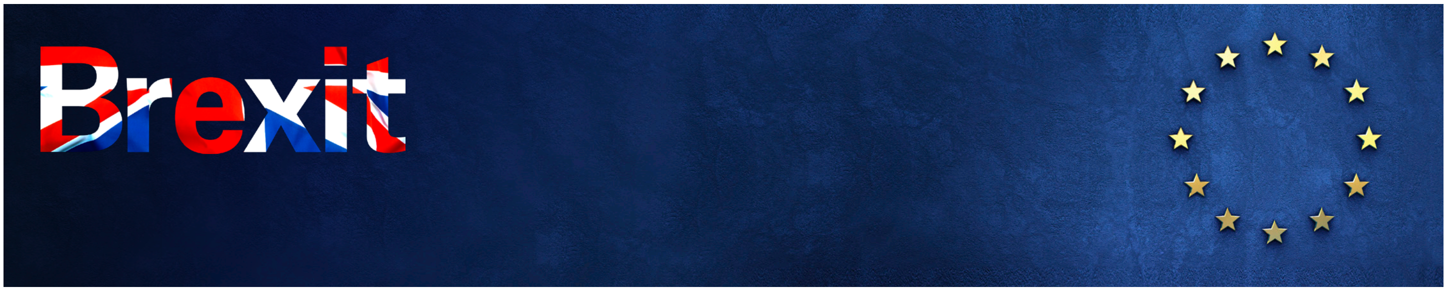

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Financial services, including insurance and reinsurance (together, (re)insurance), have effectively been omitted from the Trade and Cooperation Agreement (TCA), resulting in arguably the "hardest" Brexit for any key UK market.

In particular, the TCA:

- carves financial services/(re)insurance out of many agreed-upon areas of co-operation;
- provides no EU passporting rights for UK (re)insurers or intermediaries (or vice versa);
- allows the EU to impose requirements on cross-border financial services (subject to standard World Trade Organisation (WTO) exemptions related to such reinsurance as for marine, aviation and transport;
- permits EU member states to maintain a patchwork of sectoral/financial services requirements in relation to the UK;
- allows the EU and UK to impose financial services prudential requirements on the other's participants (with only limited exceptions); and
- makes no specific arrangements for (re)insurance or other outsourcing by EU entities to the UK (or vice versa) or the assessment of "equivalence" as between EU and UK (re)insurance regulations (prudential or otherwise).

During the TCA negotiations, the UK had also proposed treaty-level provisions for EU customers and brokers that specifically solicited cover from UK firms and a continuation of outsourcing arrangements of back-office functions to the UK. The EU rejected both requests.

Broadly, a UK participant may now access new EU (and European Economic Area, or EEA) business only via an EU-authorised subsidiary/branch or, in limited circumstances, on a cross-border basis that is subject to the requirements of the relevant EU member state. The requirements are by no means uniform and range from outright prohibition to the need to meet certain conditions. Further limitations apply in the case of UK (re)insurance intermediaries.

Market Workarounds

The UK market had already made extensive contingency plans for the worst-case scenario. Some firms incorporated a subsidiary in the EU and obtained authorisation, writing business from an EU- and UK-authorised entity in parallel. Others "reverse-branched," making use of the UK Financial Conduct Authority's temporary permissions regime to use an EU-authorised affiliate as a hub for both EU (and EEA) and UK business. As an example, Lloyd's of London incorporated a wholly owned insurance company in Belgium and secured authorisation for it to write EU (and EEA) business, outsourcing underwriting to the relevant Lloyd's managing agent and reinsuring the resulting risk to the corresponding syndicate. These plans are, as a result of the lack of clarity the TCA has provided, in most cases now in full force.

Glimmers of Hope?

The TCA does provide for some limited cooperation relevant to the (re)insurance market:

- a "best endeavours" commitment to implement international standards, including those of the International Association of Insurance Supervisors;
- an agreement to allow newly established or expanded financial services from the UK into the EU (and vice versa) on the same regulatory basis as for local firms (with authorisation to be provided within a reasonable time);
- more general provisions relating to business travel/visas; and
- an agreement to achieve "durable and stable" cooperation on financial services, including transparency and "appropriate dialogue" in relation to equivalence decisions (discussed further below). The EU and the UK are working toward reaching an agreement by March 2021 that will be documented in a memorandum of understanding (MoU).

As discussed in "A Temporary Solution for Data Protection and Digital Trade," progress has also been made on data sovereignty rules which will benefit cross-border financial services.

Next Steps: Equivalence?

Options for future progress in this area appear limited for now. The UK continues to push for marketwide arrangements with the EU. As drafted, the EU's directive on insurance regulation, Solvency II, provides for an assessment of equivalence in three areas of relevance to a third country (re)insurer: group supervision, group solvency and reinsurance. The last of these, reinsurance, would be most useful to UK reinsurers in the first instance (particularly those that have incorporated a subsidiary in the EU), with a finding of equivalence meaning that an EU cedent is entitled as of right (and without conditions) to obtain credit for reinsurance acquired from a UK reinsurer.

The UK has already, with effect from 1 January 2021, granted extensive equivalence status to the EU in respect of its financial services regulations, including for reinsurance, group supervision and group solvency, as a near-mirror image of the respective provisions of Solvency II. The similarities make sense, given that the EU and the UK are just a few weeks out of full regulatory alignment, with the UK having for decades led in the design and implementation of most EU single market financial services legislation.

The EU has, however, been more restrictive on this point, having to date granted only limited, temporary equivalence status in areas of specific EU need (*e.g.*, where it requires access to the UK's derivatives clearing operations). In 2019, the EU clarified — with a clear eye on the UK — that no third country has the right to be assessed as equivalent even if it can demonstrate that it fulfils the relevant criteria. EU equivalence assessments have become politicised in the recent past, and it appears to be political factors that explain why the UK started the year with fewer equivalence arrangements in place than other financial centres with less substantive EU alignment than the UK. As an example of this, the UK has — unlike Bermuda, Switzerland and, until 31 December 2020, Japan — no EU equivalence arrangements in place in relation to (re)insurance.

Whilst a finding of equivalence is not an essential precondition for cross-border (re)insurance of an EU cedent, and credit may be allowed by the cedent's local regime — consider the example of Lloyd's Brussels given above — a centralized determination by the European Commission (whether under the existing or a new modified regime) would go a considerable way to establishing new market norms. This, however, remains a political issue, underlined by the UK's clear stance in the TCA negotiations that it required flexibility to diverge. For example, in June 2020, the UK announced that it would be reviewing certain features of the prudential regime contained in Solvency II. Given the high level of current alignment, it does appear that an element of the EU's reluctance to grant equivalence is related to concerns about the direction financial services regulation may take in the UK.

Both the EU and the UK would benefit from increased certainty around the duration of an EU equivalence decision, once made. Whilst the UK's new equivalence regime provides that reversal of a UK decision would be a measure of last resort following breach of defined parameters, at present the EU may revoke an equivalence decision with just 30 days' notice. Given the tensions surrounding Brexit, this may not provide adequate certainty for investment decisions for many UK reinsurers. Further, even full UK equivalence under the EU's existing regime would fall short of the UK's former privileges as part of the single market. Ideally, the UK would like to see the regime extended to fill the remaining gaps, principally around primary (re)insurance, (re)insurance intermediation and related auxiliary activities. However, this may be overly ambitious at this stage.

In tandem with the above, there may be limited mileage in progressing bilateral arrangements with individual member states. As a result, parties may take advantage of areas where the TCA, Solvency II and other relevant single-market legislation are either silent or expressly leave a matter to member state discretion. In theory, individual member states may have latitude to pick their own paths with regard to certain types of cross-border activity and authorisation of third-country branches (in particular for pure reinsurance). Whilst such arrangements may develop over time, it is not clear whether individual member states have a willingness at this stage to break from the clear intention of the European Insurance and Occupational Pensions Authority for a harmonized approach in all matters regarding the UK. A better solution would be to agree to mutual recognition in respect of insurance, as the US has agreed with the EU in respect of reinsurance. This reinforces a continuing mutual interest in recognising the other state's prudential system. The WTO General Agreement on Trade in Services Financial Services Annex would permit the UK to seek mutual recognition in the same manner.

Conclusion

From a market perspective, there is limited scope for a solution to these issues without committed political engagement (and corresponding treaty-level or other provisions in place) between the EU and the UK. The ongoing negotiations, such as those around the MoU, will in turn be driven in part by commercial considerations. On one view, a continued hard Brexit in this area may lead to narrowed choices and higher prices for EU policyholders. On another view, the EU sees clear opportunities for local EU players to increase their market share. Ideally, a deal that includes increased access to the sophisticated London market and its unique expertise in dealing with complex risks will be viewed as a win-win for both sides.