

Insurers' six-point plan for Brexit

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The vote to leave the EU has profound implications for the insurance market. That is equally true whether you are a UK insurer writing cross border business or an insurer in one of the 27 remaining EU countries (EU27) writing business in the UK.

Later in this article, we set out the six priorities for insurers to ensure their business prospers once the UK has left the EU.

The big question is: 'how will insurers in the UK and across the EU27 be able to continue to sell insurance products in the other market?' Currently, this

access is achieved via passporting rights: the freedom to provide services cross border or to write business through a local branch. Yet these rights are only available to insurers operating within the European Economic Area (the EEA comprises the EU countries plus Iceland, Liechtenstein and Norway). Without a trade agreement permitting access, or a transitional agreement, this market access will be lost after Brexit.

Who will be affected?

Figures provided by Andrew Bailey, CEO at the Financial Conduct Authority¹, to Andrew Tyrie MP, Chairman of the Treasury Select Committee last August revealed that, potentially, a total of 946 insurers (firms passporting under the Solvency II directive) across both the EEA, UK and Gibraltar could be affected by the loss of passporting rights between the UK and EEA, though insurers operating solely within a single country will avoid facing this issue directly.

Although UK insurers have been more vocal in the debate for these rights

¹Letter from Financial Conduct Authority 17 August 2016



to be retained, there are actually more EU27-based insurers using passporting rights to access the UK market than vice versa. Nevertheless, the disruption caused may well be greater for UK insurers, as a result of a lack of access to 30 potential markets (EU27 plus three from the EEA).

Four main groups of insurers are likely to be significantly hit:

1. Those UK insurers that write a substantial amount of their business in the EEA countries, via freedom of

services (FOS) or through a branch network.

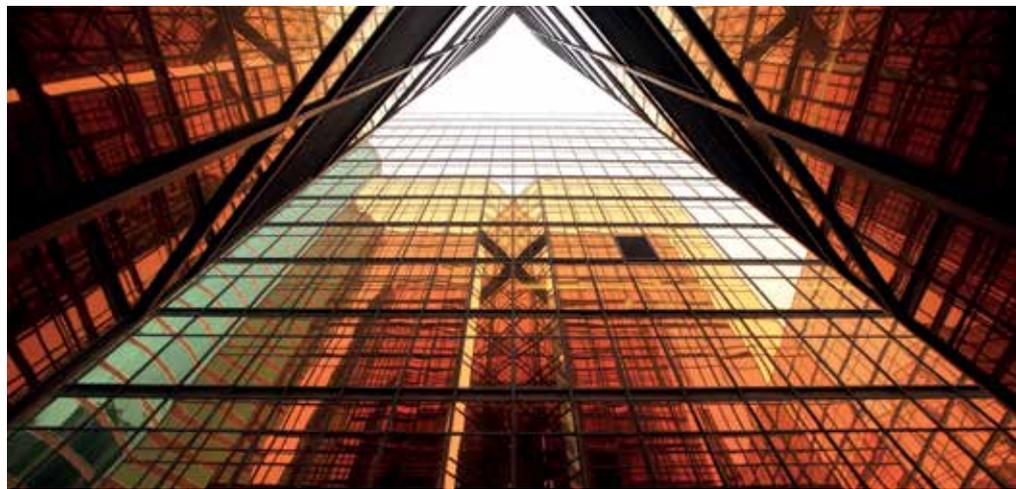
- 2.** EU-based insurers that write business in the UK through FOS licences or a branch.
- 3.** Non-EU insurance groups that have used a UK insurance company as an entry point to sell business in the EEA under FOE or FOS licences.
- 4.** Participants in the Lloyd's market.

Our insurance clients tell us they are actively reviewing Brexit's potential

impact on their ability to write business in EEA jurisdictions.

For some firms, which write purely UK business, Brexit will be a marginal issue. But, for others, they cannot afford just to wait and see how the EU-UK negotiations pan out. Restructuring takes time. What's more, it is even more important to finalise plans now, as the PRA has written to all firms operating in the UK to ask them to provide details of their contingency plans by 14 July.

“The big question is: ‘how will insurers in the UK and across the EU27 continue to sell insurance products in the other market?’”



The six things insurers should consider in order to thrive after Brexit:



Start off by thinking big



Make sure your planning is strategic, not reactive.

Clients tell us that their boards see insurance restructuring as an urgent priority. The level of assessment undertaken varies by company, but many have begun planning or even implementation. That includes an analysis of the preferred domicile for their new EU base, the required end state legal structure and the various options for restructuring. Some insurance groups have already made public announcements on their intention to restructure their legal entities.

However: this is not just about safeguarding existing business in the EEA markets. It's also about maximising opportunities. Firms should approach any restructuring plan as a way of enhancing their business as well as protecting it: a spur towards changing their business model, in terms of the products they sell – and where.

The planning process should dovetail with wider strategic considerations: decisions, say, on portfolio management (“Go or Grow?”) and dynamic strategic planning, (in terms of more sophisticated scenario analysis and developing potential game-plans).

2 Know your options



If the UK loses passporting rights – and no workable alternative emerges before exit – UK insurers will need to restructure their businesses by March 2019 to continue to write insurance business across the EEA. There are various approaches:

- **Create** (or acquire) a new licensed insurance entity in any EEA country, thereby obtain passporting rights to ensure continued access to the remaining EEA countries. The UK insurer would thereafter service the UK insurance market alone.
- **Enter** a cross-border merger between the UK insurance company and an EEA-based company and domicile the merged entity within the EEA. The UK business could then either be carried out in a ‘third country branch’, subject to UK regulatory supervision, or be transferred to a UK stand-alone insurer.
- **Change** your corporate status to a public limited company (if required) and then to a Societas Europaea (SE). Once established, an SE’s head office/registered office can be transferred from one EEA member state to another, subject to regulatory approvals.
- Where cross-border business is carried out through branches (rather than freedom of services licences), it may be possible to operate through these as locally regulated ‘third country branches’. If not, an alternative is effectively to **convert** the branches into subsidiaries. That would be less attractive in cases where the UK insurer has several EU27 branches, due to the duplication of regulatory and capital requirements. It could, however, be an option where only one or two branches are involved.
- In cases where the amount of business written in a particular country is fairly marginal and so the cost of a legal entity restructure is disproportionate, the insurer could **partner** with other firms to provide an alliance or fronting arrangement. But these come at a cost, however, and may also attract regulatory scrutiny.

“If the UK loses passporting rights – and no workable alternative emerges – UK insurers will need to restructure their businesses to continue to write insurance business across the EEA.”



3 Do your homework on timing, costs and risks



Brexit planning is unique in the scale of its likely impact on the European insurance industry and the fact that everyone is doing it at the same time. Nevertheless, all the usual considerations apply as with any other restructuring project.

In my experience, the eventual restructuring plan is likely to balance all the following:

- **Regulatory requirements**

Any form of restructuring will also require regulatory notifications and approvals. Firms need to assess whether the regulator in their preferred future domicile would be willing to take on the supervision of the proposed new EEA insurance vehicle. UK regulators, for example, have significant resources available to authorise and supervise on an ongoing basis (although even they may struggle, given the level of new UK authorisations and restructuring likely to be needed) while some other insurance markets are much smaller, with fewer regulatory and supervisory resources.

Many regulators will be able to increase their resource levels over time, but may well not be in a position immediately to take on many more insurers. If you don't move quickly, you run the risk that your preferred jurisdiction will no longer have the capacity to absorb your business, or that the process will take a long time.

- **Capital efficiency**

Insurers need to assess the potential impact on the amount of capital required and identify where this will be needed, as they will now have multiple authorisations. Any restructuring is also likely to reduce the level of capital diversification benefits achieved.

- **Tax implications**

Any plan should quantify the potential tax implications, including any tax cost of restructuring and the tax profile of the end state. This includes effective corporation tax rates, the impact on any losses and the impact on VAT recovery or creation of irrecoverable VAT. Under the EU Cross-Border Mergers Directive, there are specific tax provisions that can reduce (or even eliminate) the tax costs of a merger – positive from a restructuring perspective, although these do have conditions which will need to be met around, amongst other things, the form of the transaction. There is also significant risk that these reliefs only apply while the UK remains within the EU and so timing will be important.

- **People**

Staff issues may also present challenges. Do key decision-makers need to be based in the EU or can they operate from the UK? And to what extent can operations be outsourced back to the UK? After all, regulators will insist on sufficient local decision-makers. There are also urgent questions about staff consultation and notification requirements, and the location of significant people, functions and operations. The current free movement of people within the EEA may also disappear post-Brexit.

- **Execution risk**

And, finally, there is no point selecting an option which presents almost insurmountable execution risk in terms of legal complexity or timing, or which requires input from third parties such as courts or regulators, if this will not be available.

“Put in place robust and flexible restructuring plans and keep to a realistic timetable and you have a valuable opportunity to protect – and boost – your business growth.”



4 Be realistic about your restructuring timetable



Many restructuring options are plausible, but few, if any, are 'quick fixes'. The timeframe to plan, initiate and complete any of the options above - or a combination of them - could take well over 18 months, as the volume of restructuring proposals increases. We are now less than two years from exit. If firms are aiming to be fully ready by the end of 2018, (ready for 1 January 2019 renewals) then, realistically, they need to start their planning and implementation immediately.

Creating a new entity from scratch is costly, involves detailed planning and operational set-up and is subject to regulatory approval. Likewise, acquiring an insurer requires sourcing such companies and investigating them, which also takes time. In addition, an acquisition will involve

regulatory change of control approval. Applications for new authorisations are likely to take six to twelve months as well, so the sooner the discussions start with the regulators, the better.

I also believe that changing an insurer's legal status to an SE and use of the Cross-Border Mergers Directive will only be possible while the UK remains within the EU. Similarly, portfolio transfers will be simpler while both entities remain within the EEA.

5 Keep all doors open



No one knows how the Brexit negotiations will eventually play out. Unlike with most other restructuring projects, insurers are unclear on what exactly they must plan for.

But plan we must. And the starting point needs to be an assessment of the impact of Brexit on your business if, as seems likely, passporting rights are no longer available. Any large-scale restructuring plan must also

have sufficient flexibility to deal with any unknown, legal and regulatory outcomes of the Brexit negotiations.

I appreciate that this is easier said than done. The key is to ensure that the planning process forms part of the dynamic strategic planning of your business.

6

The time to act is now



The clock is ticking. Now that Article 50 has been triggered, the UK and EU have less than two years to prepare for Brexit. This timeline might be extended, although that would require unanimous agreement from the entire EU27 – something none of us can bank on.

Any restructuring involving insurance entities will take time and will differ widely when it comes to the scale and timetable of the change required.

Regulators in the UK and other EU27 countries are likely to face a spate of restructuring requests over the

coming year, as insurers submit new licensing applications, requests for approved persons and approvals for portfolio transfers. These additional demands could severely strain regulators' resources.

The earlier insurers start planning, the more chance they have of gaining regulatory approval.



A genuine opportunity

These are challenging times for the insurance industry. Yet, while the outcome of the Brexit process remains unclear, put in place robust and flexible restructuring plans and keep to a realistic timetable and you have a valuable opportunity to protect – and boost – your business growth.

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