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Brexit & financial services

Insurance and Reinsurance

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Introduction

As a result of Brexit, insurers and reinsurers that are established and regulated in the UK have lost the passporting rights that permitted them to conduct insurance business in EEA Member States on a services or establishment basis under Solvency II. Similarly, insurers and reinsurers established and regulated in an EEA State can no longer passport into the UK.

This note outlines the options now available to (and the constraints applicable to)

– a UK (re)insurance firm or group that wishes to either (a) continue to provide (re)insurance cover in respect of 'EEA risks' (that is, cover for insureds in the EEA, or in respect of risks situated in the EEA); or (b) service existing contracts of (re)insurance covering EEA risks, perhaps to run-off that business; and

– an EEA (re)insurer that wishes to carry on (re)insurance business in the UK, including to run-off their existing book of UK (re) insurance business.

Each option carries with it implications for, amongst other things, the capital requirements and group supervision arrangements that might apply to the firms concerned. Those implications require detailed analysis based on the particular circumstances of the firms concerned and are outside the scope of this note.

Background

In considering what options are available to UK and EEA firms in the aftermath of Brexit, an important threshold question is, how much business can a UK or EEA (re)insurer or insurance distribution firm do on a cross-border basis into the EEA or the UK (as the case may be) and without having to be authorised in an EEA Member State or the UK (again, as the case may be)? Putting the same question in more colloquial terms, a UK insurer might ask, what if I just stay in London and wait for EEA customers to come to me, or pay claims on contracts of (re) insurance that I have already written for EEA customers? Surely, I don't need an EEA authorisation to do that? An EEA (re)insurer might ask the same question about its dealings with UK policyholders. It turns out that the answer to this question is complicated and discloses a fundamental difference of approach as between UK and EU insurance regulation.

The UK regime

UK financial services regulation is mostly 'activity based'. The basic principle is simple: UK financial services regulation does not bite on (a) activities that are not carried on in the UK; or (b) an invitation to engage in regulated financial services business, if the invitation originates outside the UK and is not capable of having an effect in the UK.

One consequence of this approach is that it is not problematic in principle for a third-country (re)insurer to (re)insure UK risks, or UK policyholders, on a cross-border basis and without a UK authorisation, provided that the (re)insurance business in question is not 'in the UK'; and provided that any invitation to engage in that business has been made in a way that complies with the UK financial promotion regime. This is in part because, in policy terms, the UK has long recognised that access to third-country (re)insurance capacity is important for the UK economy. Of course, it is not always easy in practice to identify when a particular activity is carried on 'in the UK' and the difficult question as to whether or not an insurance business is carried on 'in the UK' is considered below.

The UK regulatory framework generally treats reinsurance (or retrocession) as the insurance of risks assumed by an insurer or reinsurer. 'Insurance business' is, therefore, understood to include the business of reinsurance or retrocession. Accordingly, in what follows, a reference to 'insurance' or 'insurance business' should be understood to include a reference to reinsurance or retrocession, unless there is a specific indication to the contrary.

The EU regime

The trigger for the applicability of EU insurance regulation is generally that the insured risk, or the policyholder, is located in the territory of the single market. The preference for that trigger is bound up in the legal history of the single market itself. In 2000 the European Commission issued an Interpretative Communication setting out its view as to the circumstances in which an insurance undertaking in one Member State should be regarded as exercising the freedom to provide services in another Member State. For present purposes, an important principle identified by the Commission in that document is that:

> *'an activity which consists in providing on a lasting basis services from the home Member State and does not involve movement by the service provider to the Member State of provision falls within the scope of the rules on the freedom to provide services'.*[1]

This principle is based on the CJEU decision in Case C-56/96, *VT4* [1997]. In that case the Court held that VT4, a Flemish language broadcaster established in the UK, but transmitting exclusively to Belgium, was legitimately established in the UK and exercising its freedom to provide services in Belgium. In doing so, the CJEU rejected the argument of the Belgian government that VT4 was abusing its freedom to provide services, because it had established itself in the UK (where it did not provide any services at all) only to avoid Belgian law applying to broadcasters.

The significant point that flows out of this background is that, even before Brexit, if a UK (re)insurer were to manage claims in relation to its EEA (re)insurance business exclusively by (a) sitting in London waiting for EEA policyholders to bring claims to it; and then (b) dealing with those claims exclusively in and from London, it would nevertheless have been regarded, in EU legal terms, as exercising its freedom to provide services in the Member States in which its EU policyholders were established. Beyond this technical point there is also the obvious political point, that the EU has no interest in allowing access to the single market by firms that are not established in a Member State. But the point is not purely political, it has a long legal history too.

In summary, for both technical and political reasons, and in sharp contrast with UK insurance regulation, EU insurance regulation does not generally[2] countenance a business model in which a (re)insurer or insurance distribution firm provides cross-border insurance services from outside the EEA, covering risks or policyholders located in the EEA.

1 Idem, p. 7.
2 Pure reinsurance business is a possible exception. See below.

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Insurers and Reinsurers established in the UK doing business in the EEA

The options now open to a UK (re)insurance firm or group that wishes to either continue to provide (re)insurance cover in respect of 'EEA risks'; or service existing contracts of (re)insurance covering EEA risks are as follows:

1. UK (re)insurance group (re)insures EEA risks through a new stand-alone (re)insurer, authorised and regulated in an EU Member State;
2. UK insurance firm insures (and possibly also reinsures) EEA risks through a branch authorised in an EU Member State;
3. UK pure reinsurance firm reinsures EEA risks through a branch authorised in an EU Member State;
4. UK pure reinsurance firm reinsures EEA risks on a cross-border basis, without an establishment in an EU Member State;
5. UK (re)insurance firm or group implements any of options 1, 2 or 3 above, but seeks to outsource functions back to the UK; and
6. UK (re)insurance firm services existing contracts of insurance (i.e. 'legacy EEA business'), on a cross border basis, without an establishment in the EU.

The option missing from this menu is the provision of (re)insurance services into the EEA on a cross-border basis and without an establishment or authorisation in the EEA. With the possible exception of pure reinsurance business (Option 3), EU insurance regulation does not countenance a business model in which a (re)insurer provides cross-border insurance services from outside the EEA, covering risks or policyholders located in the EEA, without an authorisation in an EEA State. It follows that Option 6 (servicing legacy EEA business, discussed below), is a problematic special case.

1. Providing insurance or reinsurance through a (re)insurer established in an EU Member State

Solvency II, Art. 14 (Principle of authorisation) provides that:

'1. The taking-up of the business of direct insurance or reinsurance covered by this Directive shall be subject to prior authorisation.

2. The authorisation referred to in paragraph 1 shall be sought from the supervisory authorities of the home Member State by the following:

(a) any undertaking which is establishing its head office within the territory of that Member State...'

Solvency II, Art. 15(1) (Scope of authorisation) elaborates:

'An authorisation pursuant to Article 14 shall be valid for the entire Community. It shall permit insurance and reinsurance undertakings to pursue business there, that authorisation covering also the right of establishment and the freedom to provide services.'

A UK (re)insurance firm or group may establish a stand-alone insurance entity (perhaps as a sister company or a subsidiary of an existing UK entity) authorised and regulated in an EEA State. The group may then seek to transfer the legacy EEA business of the UK (re)insurer to that entity; and to write new business covering EEA risks and policyholders, through that entity. The European Commission has indicated[3] that this is a viable option:

'EU-27 subsidiaries (legally independent companies established in EU-27 and controlled by or affiliated to insurance undertakings established in the United Kingdom) can continue to operate as EU insurance undertakings on the basis of their authorisation in the EU Member State of their establishment and subject to their compliance with the EU rules, including in terms of governance, risk management, and outsourcing.'

The advantage of this arrangement is that the new entity will have the right to passport into any EEA State in order to conduct insurance business there. The disadvantage is cost (both in setting up and operating the new entity). The group may seek to mitigate that cost by making use of the existing insurance expertise available to the UK (re)insurer, in the operation of the new EEA (re)insurer.

2. Providing direct insurance through a branch in an EU Member State

Solvency II, Chapter IX sets out a regime under which third-country insurers may obtain authorisation in an EEA State by establishing a branch[4] in that State. Art. 162(1) provides that:

'Member States shall make access to the business referred to in the first subparagraph of Article 2(1) by any undertaking with a head office outside the Community subject to an authorisation.'

The first sub-paragraph of Solvency II, Art. 2(1) refers to:

'direct life and non-life insurance undertakings which are established in the territory of a Member State or which wish to become established there.'

That sub-paragraph refers to 'undertakings', not 'business'. However, Art. 162 is understood[5] to permit third country insurers to conduct direct life and direct non-life insurance business in an EEA State, provided they are authorised to conduct that business by the relevant authority in that State.

By extension, however, the regime established under Art. 162 is not available to a third-country pure reinsurer.[6] Pure reinsurers are treated separately, under Solvency II, Art. 174, which is addressed below. Third-country firms that carry on a combination of insurance and reinsurance business are not separately addressed in Solvency II. It follows that the treatment of such firms will be a matter for the law of each Member State of the EEA.

Solvency II, Art. 162(2) provides that:

'A Member State may grant an authorisation where the undertaking fulfils at least the following conditions...' (emphasis added).

3 European Commission, 'Notice to Stakeholders: Withdrawal of the United Kingdom and EU rules in the field of insurance / reinsurance', 8 February 2018.
4 Solvency II, Art. 162(3) provides that 'for the purposes of this Chapter, "branch" means a permanent presence in the territory of a Member State of ... [a third-country insurer], which receives authorisation in that Member State and which pursues insurance business.'
5 For example, Herbst et al., Brexit and Financial Regulation, OUP, 2020, ¶ 16.44.
6 In the jargon of Solvency II, Art. 2(1), second sub-paragraph, read with the Art. 13(4) definition of a 'reinsurance undertaking', a pure reinsurer is 'an undertaking which has received authorisation ... to pursue reinsurance activities [and] which conduct[s] only reinsurance activities'.

It is clear from the phrase 'at least the following conditions' that the conditions for authorisation in Solvency II, Art. 162(2) are minimum conditions and do not prevent the State in question from imposing additional conditions of its own design. That is consistent with shared legislative competence between the EU and Member States, discussed in the Overview note in this series. The minimum conditions include that the third-country insurer:

'(a)... is entitled to pursue insurance business under its national law;

(b) establishes a branch in the territory of the Member State in which authorisation is sought;

(c)... undertakes to set up at the place of management of the branch accounts specific to the business which it pursues there, and to keep there all the records relating to the business transacted;...

(e)... possesses in the Member State in which authorisation is sought assets of an amount equal to at least one half of the absolute floor... of the Minimum Capital Requirement and deposits one fourth of that absolute floor as security;

(f)... undertakes to cover the Solvency Capital Requirement and the Minimum Capital Requirement... [with eligible own funds];...

(h)... submits a scheme of operations in accordance with the provisions in Article 163;

(i)... fulfils the governance requirements[7] laid down in Chapter IV, Section 2.'

The opportunity that Solvency II, Art. 162 offers a third-country insurer to obtain authorisation in an EEA State is subject to an important limitation. A branch authorised in one EEA State does not enjoy passporting rights of its own. Accordingly, if a third-country insurer seeks to use the branch model to do business in more than one EEA State, it must (a) establish a separate branch; and (b) seek separate authorisation, in each relevant State.

Solvency II, Art. 167 alleviates that burden somewhat, by providing for a range of concessions, for which a third country insurer that is authorised in more than one EEA State may apply. The possible concessions are specified in Art. 167(1). They include that:

'(a) the Solvency Capital Requirement... shall be calculated in relation to the entire business which it [i.e. the third-country insurer] pursues within the Community; [and]...

(c) the assets representing the Minimum Capital Requirement shall be localised... in any one of the Member States in which it pursues its activities.'

There are, however, a number of 'catches' in, Solvency II, Art. 167(3) and (4), including the following:

'3. The advantages provided for... may be granted only where the supervisory authorities of all Member States in which an application has been made agree to them [; and]...

4. At the request of one or more of the Member States concerned, the advantages granted... shall be withdrawn simultaneously by all Member States concerned.'

3. Providing pure reinsurance through a branch established in an EEA State

Solvency II, Art. 174 (Principle and conditions for conducting reinsurance activity) provides that:

> *'A Member State shall not apply to third-country reinsurance undertakings taking-up or pursuing reinsurance activity in its territory provisions which result in a more favourable treatment than that granted to reinsurance undertakings which have their head office in that Member State.'*

It follows, therefore, that the treatment of branches of a third-country reinsurer is a matter for the law of the relevant EEA State, subject only to the admonition against providing more favourable treatment than is given to domestic reinsurers. This has been confirmed[8] by the European Commission:

> *'UK reinsurance undertakings will have to comply, for their EU business, with the conditions set by the EU Member State in which they carry out their activity. These conditions cannot be more favourable than those applying to reinsurance companies from the EU,... but they may be less favourable and may well differ between EU Member States: for example, Member States are free to require the pledging of assets or the establishment of a branch by the third country reinsurer.'*

4. Providing pure reinsurance on a cross-border basis without an establishment in an EEA State

Solvency II, Art. 175 permits the European Commission to propose agreements with third-countries 'regarding the means of exercising supervision over... third-country reinsurance undertakings which conduct reinsurance business in the Community'. The stated purpose of those agreements is to seek to:

> *'ensure, under conditions of equivalence of prudential regulation, effective market access for reinsurance undertakings in the territory of each contracting party and provide for mutual recognition of supervisory rules and practices on reinsurance'.*

A possible consequence of such an agreement is a determination of 'equivalence' under Solvency II, Art. 172(3), which provides that:

> *'Where... the solvency regime of a third country has been deemed to be equivalent to that laid down in this Directive, reinsurance contracts concluded with undertakings having their head office in that third country shall be treated in the same manner as reinsurance contracts concluded with undertakings authorised in accordance with this Directive.'*

The relevance of a determination of equivalence under Art 172 emerges from the Delegated Regulation, Art. 211 which specifies limited circumstances in which an EU insurer or reinsurer can take the risk-mitigation benefit of outwards reinsurance with a third-country reinsurer. One such circumstance is that the reinsurer is situated in a country whose solvency regime is deemed equivalent or temporarily equivalent to that laid down in Solvency II, in accordance with Article 172.

7 These are the same governance requirements as apply to any insurer authorised under Solvency II.

8 European Commission, 'Notice to Stakeholders: Withdrawal of the United Kingdom and EU rules in the field of insurance / reinsurance', 8 February 2018, ¶ 1.

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5. Outsourcing functions back to the UK

Both insurers established in the EEA and UK insurers that establish a branch in the EEA (pursuant to Solvency II, Art. 162) are subject to the governance requirements in Solvency II, Chapter IV, Section 2. These include requirements on outsourcing, set out in Solvency II, Art. 49:

'1. Member States shall ensure that insurance and reinsurance undertakings remain fully responsible for discharging all of their obligations under this Directive when they outsource functions or any insurance or reinsurance activities.

2. Outsourcing of critical or important operational functions or activities shall not be undertaken in such a way as to lead to any of the following:

(a) materially impairing the quality of the system of governance of the undertaking concerned;

(b) unduly increasing the operational risk;

(c) impairing the ability of the supervisory authorities to monitor the compliance of the undertaking with its obligations;

(d) undermining continuous and satisfactory service to policy holders.

3. Insurance and reinsurance undertakings shall, in a timely manner, notify the supervisory authorities prior to the outsourcing of critical or important functions or activities as well as of any subsequent material developments with respect to those functions or activities.'

Solvency II, Art. 50(2)(b) requires EIOPA to:

'develop draft regulatory technical standards to further specify... the conditions for outsourcing, in particular to service providers located in third countries.'

As at the time of writing (January 2021), EIOPA has not published the draft regulatory technical standard ('the RTS') to which this Article refers. It follows, therefore, that (a) each EEA State will have implemented Solvency II, Art. 49 in its own way; and (b) that the extent to which an EEA insurer (or a branch of a UK insurer) may legitimately delegate functions back to the UK, will be determined by the law and practice of the Member State in which the insurer or the branch is established.

6. Servicing legacy EEA insurance business

As explained above, EU insurance regulation does not generally[9] countenance a business model in which a (re)insurer provides cross-border insurance services from outside the EEA, covering risks or policyholders located in the EEA, without an authorisation in an EEA State.

It follows that servicing legacy EEA business is, from the EEA perspective, a problematic special case, which creates an obvious tension between the welfare of EEA policyholders and the integrity of the single market. That explains the line that EIOPA has taken from the first, in its communications about the potential impact of Brexit on the servicing of contracts of insurance writing by UK insurers. This example is from 2017:

'2.3. Solvency II allows insurance undertakings to pursue business in the European Union, only if the undertaking is authorised in the European Union. Based on this authorisation undertakings may conduct business on a... freedom to provide services basis in other Member States. Solvency II allows a third country undertaking to pursue business in a Member State of the European Union through an authorised third country branch.

2.4. Upon withdrawal from the single market and in absence of a political agreement between the European Union and the UK to the contrary, UK insurance undertakings lose their right to conduct business in the Member States of the European Union by way of... freedom to provide services....

2.5. Insurance contracts concluded before the Withdrawal date by UK insurance undertakings in the... by way of freedom of establishment and freedom to provide services are in principle valid after that date. The insurance undertakings would however not be authorised anymore to carry out insurance activities with regard to these cross-border insurance contracts by way of... freedom to provide services. This includes insurance portfolios in run-off.'[10]

The European Commission took the same line in 2018:

'UK insurance undertakings... will no longer be allowed to provide services in the EU, including through online sales,... on the basis of their current authorisations.'[11]

However, the shared competence of the EU and Member States in relation to the single market, provides some flexibility, to cater for the unprecedented situation of a Member State exit from the EU. For example, in its communication in 2019, EIOPA indicates as follows:

'Recommendation 1 – General objective

14. In their treatment of cross-border business of UK insurance undertakings, competent authorities should aim to minimise the detriment to policyholders and beneficiaries, based on the applicable EU and national laws.

9 Pure reinsurance business is a possible exception. See Option 4 above.
10 EIOPA, Opinion on service continuity in insurance in light of the withdrawal of the United Kingdom from the European Union EIOPA-BoS-17/389, 21 December 2017.
11 European Commission, 'Notice to Stakeholders: Withdrawal of the United Kingdom and EU rules in the field of insurance / reinsurance', 8 February 2018.

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Recommendation 2 – Orderly run-off

15. *Competent authorities should apply a legal framework or mechanism to facilitate the orderly run-off of business which became unauthorised or they should require the insurance undertakings to immediately take all necessary measures to become authorised under Union law.*

16. *Competent authorities should prevent that UK undertakings conclude new insurance contracts or establish, renew, extend, increase or resume insurance cover under the existing insurance contracts in their jurisdiction as long as they are not authorised for such insurance activities under Union law. This is without prejudice to policyholder rights to exercise an option or right in an existing insurance contract to realise their pension benefits.*

17. *Competent authorities should make every effort to supervise the cross-border business of UK insurance undertakings in their jurisdictions. The supervision should include conduct supervision and, in co-operation with the supervisory authorities in the UK, appropriate oversight of the relevant prudential aspects of the cross-border business, including the financial position of the UK undertaking. The supervision should be risk-based and take into account proportionality."*[12]

In substance, this material recognises the legal reality that the implementation of Solvency II is the responsibility of individual Member States, each of which has a margin of discretion as to how to give effect to the requirements of that directive. Unsurprisingly, that legal reality is also reflected in communications from UK regulators, as this example from the FCA shows:

> *'Servicing your EEA customers after the transition period ends*
>
> *If you have customers based in the EEA, you should already have decided on your approach to servicing your existing contracts with them.... You should take the steps available to you to continue to service customers in accordance with local law and national regulators' expectations.... Whether you need regulatory permissions in a local EEA jurisdiction will depend on local law and the approach of the local authorities in that jurisdiction...'.*[13]

Insurers and Reinsurers established in the EEA doing business in the UK

The options now available to (and the constraints applicable to) an EEA (re)insurer that wishes to carry on (re)insurance business in the UK, including to run-off their existing book of UK (re)insurance business are as follows:

1. EEA insurance firm or group establishes an authorised subsidiary in the UK;
2. EEA insurance firm establishes an authorised branch in the UK;
3. EEA insurance firm or group implements either of Option 1 or Option 2 by way of the UK Temporary Permission Regime ('the TPR');
4. EEA (re)insurance firm enters the Financial Services Contracts Regime ('the FSCR') in order to run-off its existing UK insurance business; and
5. EEA (re)insurance firm provides (re)insurance in the UK on a cross-border basis and without a UK authorisation.

1. Obtaining authorisation for an insurer in the UK

The route to authorisation followed by UK domestic entities that wish to carry on insurance business, is indirect. The intending insurer must apply for a FSMA 2000 'Part 4A permission',[14] to carry on the regulated activities that make up insurance business. These are primarily[15] the regulated activities of effecting or carrying out contracts of insurance as principal. Authorisation follows automatically, when the required permissions are granted.

Because insurers are dual-regulated under FSMA 2000, an applicant for authorisation must satisfy the threshold conditions for authorisation that are relevant to both the PRA and the FCA. For administrative convenience, however, the application for authorisation will be made to the PRA, which will lead the process of responding to and evaluating the application and will liaise with the FCA as necessary.

12 EIOPA, 'Recommendations for the insurance sector in light of the United Kingdom withdrawing from the European Union', EIOPA-BoS-19/040, 19 February 2019.
13 FCA, 'Brexit: information for general insurers and intermediaries in the UK', 7 July 2020.
14 FSMA 2000, s. 55A(5).
15 Noting that, in practice, a firm that is authorised to effect or carry out contracts of insurance as principal will also obtain permission for a range of other regulated activities that underpin that business – for example permission to carry on insurance distribution activities.

Threshold conditions for authorisation

The threshold conditions for authorisation (specified in FSMA 2000, Schedule 6) are the minimum standards that an entity must meet in order to obtain (and maintain) authorisation under FSMA 2000. As a dual-regulated firm, an insurer must, in order to obtain and maintain authorisation under FSMA 2000, meet threshold conditions that are relevant to the statutory objectives of both the PRA and the FCA. By way of example only:

FSMA 2000, Schedule 6, Part 1C specifies the threshold conditions 'for which [the] FCA is responsible in relation to PRA-authorised persons'. It provides in part as follows:

'3B Effective supervision

(1) B [(i.e. the insurer)] must be capable of being effectively supervised by the FCA having regard to all the circumstances...

3C Appropriate non-financial resources

(1) The non-financial resources of B must be appropriate in relation to the regulated activities that B carries on or seeks to carry on, having regard to the operational objectives of the FCA.

3D Suitability

(1) B must be a fit and proper person, having regard to the operational objectives of the FCA.

3E Business model

B's business model (that is, B's strategy for doing business) must be suitable for a person carrying on the regulated activities that B carries on or seeks to carry on, having regard to the FCA's operational objectives.'

FSMA 2000, Schedule 6, Part 1D specifies the threshold conditions 'for which the PRA is responsible in relation to Insurers...'. It provides in part, as follows:

'4B Legal status

C [(i.e. the insurer)] must be—

(a) a body corporate (other than a limited liability partnership),..., or

(c) a member of Lloyd's.

4C Location of offices

(1) If C is a body corporate incorporated in the United Kingdom—

(a) C's head office, and

(b) if C has a registered office, that office,

must be in the United Kingdom...

4D Business to be conducted in a prudent manner

(1) The business of C must be conducted in a prudent manner.

(2) To satisfy the condition in sub-paragraph (1), C must in particular have appropriate financial and non-financial resources...

4E Suitability

(1) C must be a fit and proper person, having regard to the PRA's objectives...

4F Effective supervision

(1) C must be capable of being effectively supervised by the PRA...'

Process and time-line

Applying for UK authorisation is a detailed and complex process that almost inevitably requires professional advice and assistance. Even under 'business as usual' conditions, a straightforward application can take up to a year. The process may be longer if the application for authorisation of a UK insurance firm (perhaps as a sister company or subsidiary of the EEA insurer), is associated with an application under FSMA 2000, Part VII to effect a bulk transfer of the insurance business of a former UK branch to the newly authorised UK insurance firm.

2. Obtaining authorisation for a branch in the UK

A third-country insurer may apply for the authorisation of a branch established in the UK. In principle, that application for authorisation is no different from an application for the authorisation of UK subsidiary. The insurer must apply to the PRA for permission to carry on the regulated activities that make up insurance business, albeit through a UK branch. Permission will not be granted unless the relevant PRA and FCA threshold conditions are met. The firm will be authorised once permission is granted and will thereafter be dual-regulated by the FCA and the PRA.

The complication, of course, is that whereas the FCA and the PRA are the primary regulators of a UK insurer, that is not the case for the UK branch of a third-country insurer. Regulatory competence is shared between the PRA and the FCA on the one hand; and the insurer's home state supervisor on the other. In the nature of things, given that the FCA's remit is focussed on conduct risks, this issue is most acute for the PRA, which must determine the prudential soundness of the business conducted by the branch in the UK (and the consequent risks to consumers in the UK and the PRA's statutory objectives), but in the context of the prudential soundness of the wider business carried on by the insurer elsewhere in the world.

The PRA has set out[16] its approach to that problem in rules and in Policy Statements. The relevant rules are in the Third Country Branches ('TCB') Part of the sector of the PRA Rulebook applicable to Solvency II firms. Perhaps the most striking rule is TCB 13 (Worldwide financial resources):

'13.1 A third country branch undertaking must maintain adequate worldwide financial resources, to ensure that there is no significant risk that its liabilities cannot be met as they fall due.'

The PRA has set out its approach to the application of this rule in the following terms:

'4.1 For this purpose, the PRA will consider the undertaking's compliance with the prudential regime under which it is supervised in its home country.

4.2 The PRA expects the third-country branch undertaking to provide sufficient information so that the PRA may form an opinion on the adequacy of the worldwide financial resources of the undertaking.

16 PRA, 'Supervisory Statement SS44/15 Solvency II: third-country insurance and pure reinsurance branches', November 2015.

4.3 *Where the PRA assesses the home country regime to be broadly equivalent to the regime applied by the PRA to (re)insurers whose head office is in the UK, then compliance with the financial resources requirements of that prudential regime may be relied on by the third country branch undertaking as tending to establish compliance with the PRA's worldwide financial resources rule....*

4.4 *Where that prudential regime is not broadly equivalent to the regime applied by the PRA... then the PRA will assess the adequacy of financial resources using the methods and techniques applicable to (re)insurers whose head office is in the UK.'*

In 2018 (and no doubt with Brexit in mind) the PRA provided[17] further detail on its approach to the authorisation of third-country branches. The PRA indicated that in addition to being satisfied that the insurer's home country prudential regime is 'broadly equivalent' to that operated by the PRA, the PRA needs to be satisfied that:

'- the firm is capable of being supervised effectively by the home supervisor;

- the whole firm is able to meet the Threshold Conditions;

- there is sufficient supervisory cooperation with the home supervisor;

- UK policyholders of the firm will be given the appropriate priority in an insolvency and that there is no discrimination against policyholders whose business is written in the United Kingdom in the event of a winding up;

- the firm is able to meet relevant PRA rules, including... on its implementation, the full Senior Managers and Certification Regime applicable to the relevant individuals responsible for the branch;

- given the scale of UK branch activity covered by the... protected amount covered by the FSCS [i.e. the UK Financial Services Compensation Scheme] can be absorbed by insurers liable to contribute to the FSCS; and

- the impact of the failure of a firm with a UK branch on the wider UK insurance market and financial system would not lead to broader instability.'

If the PRA is not satisfied as to these issues it is likely to reject the application for authorisation. Alternatively, the PRA may in some cases insist that instead of establishing a branch in the UK, the third-country insurer establishes a subsidiary in the UK.[18] On the face of it, however, if the third-country insurer is established in the EEA, it ought to be relatively straightforward for the PRA to satisfy itself as to the adequacy of the local supervisory regime.

3. The Temporary Permission Regime

The essentials of the UK Temporary Permission Regime ('the TPR') are outlined in the Overview note in this series. The purpose of the TPR is to provide an EEA firm that has exercised passport rights to carry on insurance business in the UK on a freedom of establishment, or a freedom of service basis, an enhanced opportunity to seek the authorisation of a UK branch,[19] should it wish to do so. The TPR creates that enhanced opportunity by providing that if the EEA firm (a) made an application for UK branch authorisation before the end of the initial Brexit transition period (i.e before 31 December 2020); and (b) is admitted to the TPR, it will be deemed to have a FSMA 2000, Part 4A permission (covering the activities that it carried on immediately before the end of the current transition period) for up to three years after the end of the transition period, while its application for branch authorisation is processed, or until its deemed permission is revoked, whichever happens earlier.

4. The Financial Services Contracts Regime

The essentials of the Financial Services Contracts Regime ('the FSCR') are set out in the Overview note. In summary, the FSCR provides both (a) a regime for the lawful run-off of legacy insurance business carried on in the UK by an EEA firm on a freedom of services basis; and (a) a supervised regime for the lawful run-off of legacy insurance business carried on in the UK by an EEA firm that operated in the UK on a freedom of establishment basis, but does not propose to establish an authorised branch here; or which entered the TPR but failed to obtain a UK branch authorisation.

5. Carrying on insurance business on a cross-border basis without a UK authorisation

Because UK financial regulation (including insurance regulation) is activity based, it is possible in principle and in practice for an insurer established outside the UK to provide cover for risks and policyholders located in the UK, without a UK authorisation (i.e. 'on a non-admitted basis'). The essential conditions underlying this option are (a) that the insurer does not carry on business 'in the UK' even though it is covering risks or policyholders located in the UK; and (b) that the insurer complies with the restrictions in or under FSMA 2000 on financial promotions capable of having an effect in the UK.

Carrying on insurance business in the UK

The three primary regulated activities that the UK identifies as characteristic of the business of a (re)insurer, or '(re)insurance business' are 'Effecting contracts of insurance as principal',[20] 'carrying out contracts of insurance as principal'[21] and agreeing to do either of those things.[22] As summarised in *Re Whiteley Insurance Consultants* [2008] EWHC 1782 (Ch), *per* David Richards J:

'To effect a contract of insurance is to enter into new business and to carry out a contract of insurance is to perform obligations under the contract, including the payment of claims: Re AA Mutual Insurance Co Ltd [2004] EWHC 2430 (Ch), [2005] 2 BCLC 8 at para 14 per Lewison J. The purpose of the addition of the words "as principal", which had not appeared in earlier equivalent legislation, was to confirm that it did not extend to agents duly authorised by insurers: see In re a Company (No 007816 of 1994) [1997] 2 BCLC 685.'

17 PRA, 'Supervisory Statement | SS2/18 International insurers: the Prudential Regulation Authority's approach to branch authorisation and supervision', March 2018.
18 Establishing a subsidiary might be a good mitigant if, for example, the PRA is concerned that the nature or scale of the activities wider company expose the UK branch (and so UK policyholders or the FSCS) to unacceptable risk.
19 A condition for access to the TPR being that the firm is authorised in its EEA Home State (or else it would have been unable to exercise passporting rights).
20 RAO, Art. 10(1).
21 RAO, Art. 10(2).
22 RAO, Art. 64.

Entering into new business means more than just 'making' the contract: see *Stewart v Oriental Fire and Marine Insurance Co Ltd* [1985] QB 988 at 101, cited with approval by the Court of Appeal in *Re a company (No 007816 of 1994)* [1997] 2 BCLC685 (CA) *per* Lord Woolf, at 694:

> *'"effecting" a contract of insurance seems to me to involve more than making the contract. There may also be involved... the offering of insurances and the negotiation of the terms of the contract'.*

FSMA 2000, s. 418 (Carrying on regulated activities in the United Kingdom) deems certain activities to be carried on in the UK if, for example, a financial services business has its head office or its registered office in the UK, or maintains an establishment in the UK, from which the relevant activity is carried on.

In EU law, an 'establishment' in a host state requires some sort of permanent presence in that state. In the insurance context, the European Commission has expressed the opinion (which may now be less relevant post-Brexit) that:

> *'... an insurance undertaking of another Member State which maintains a permanent presence in the Member State in question comes within the scope of the provisions of the Treaty on the right of establishment, even if that presence does not take the form of a branch or agency, but consists merely of an office managed by the undertaking's own staff or by a person who is independent but authorised to act on a permanent basis for the undertaking, as will be the case with an agency'.*[23]

As to what is meant by 'a permanent place of business' in English law, in *Re Oriel Ltd* [1986] 1 WLR 180 the Oliver LJ held, at p. 184, that:

> *'when the word "established" is used adjectively, ... it connotes not only the setting up of a place of business at a specific location, but a degree of permanence or recognisability as being a location of the company's business.'*

In *Financial Services Authority v Fraser Lindhart & Webb* [2001] Lexis Citation 09, Simon Berry QC applied *Re Oriel* to the construction of the phrase 'carrying on investment business from a permanent place of business maintained by it in the United Kingdom', in the Financial Services Act 1986. He held, at [7] that:

> *'The essential thinking... is that, if there is some activity, even if it is only an incidental one, carried on at premises by a business and if those premises are also... advertised and held out as being a place of business of the business, then that can have the effect that they can be an established place of business; and all the more so if it is a fixed place... which is continually used'.*

Other than by way of FSMA 2000, s. 418, the Act does not define when insurance business is 'carried on in the United Kingdom'.[24] The English courts apply the language of FSMA 2000 to the particular facts of each case. Most of the relevant decisions date from before FSMA 2000 came into force but they remain authoritative because, on this issue, the language of the predecessor legislation and the language of FSMA 2000 are substantially similar. By way of example, the English courts have held that:

Insurance business includes all the activities for which insurers have to make arrangements if they are to carry on their business of accepting risks *(Re a company (No 007816 of 1994)* [1997] 2 BCLC685 (CA), *per* Lord Woolf MR, at p. 695).

No single act, out of that multiplicity of acts, can be isolated and treated as determinative of the place where insurance business is carried on *(Re a Company (No 007923 of 1994)* [1995] 1 BCLC 594, *per* Knox J, at p. 603H). So, for example, in *Scher v. Policyholders Protection Board* [1994] 2 A.C. 57 (HL), Lord Goff held, at p. 101, that the performance in the UK of a particular obligation under a contract of insurance does not, by itself, require authorisation:

> *'only if the insurer without authorisation effects or carries out a contract of insurance as part of an insurance business in this country will such effecting or carrying out be prohibited.'*

The Court is concerned with the more general question as to whether what is done in the United Kingdom amounts, in all the circumstances, to carrying on insurance business in the United Kingdom *(Re a Company (No 007816 of 1994)* [1995] 2 BCLC 539, *per* Jonathan Parker J at p. 563).[25]

The test is whether activities in the UK are of 'sufficient regularity and substance to constitute the carrying on of business in the UK' (*Financial Services Authority v Fradley and Woodward* [2005] EWCA 1183, *per* Arden LJ, at [53]).

The Court will treat the activities of the insurer's agents as the activities of the insurer. (*Re a company (No 007816 of 1994*) [1997] 2 BCLC 685 (CA), *per* Lord Woolf MR, at p. 696) The Court will put particular weight on agent activities in the UK that are not isolated incidents but are systematic and regular.

Overall, given the fact-sensitive nature of the required determination and the fact that it is a criminal offence to carry on a regulated activity by way of business in the UK without authorisation or exemption, a prudent insurer will obtain specialist advice before seeking to cover UK risks or UK policyholders on a non-admitted basis.

<u>The financial promotion restriction</u>

An overseas insurer intending to cover UK risks or UK policyholders on a non-admitted basis may consider promoting the insurance that it underwrites to potential customers in the UK. In that case the insurer should keep in mind the financial promotion restriction in FSMA 2000, s. 21(1) ('the FPR').

The FPR applies the communication of an invitation to 'engage in investment activity' if the communication is (a) within the scope of the FPR; (b) made by way of business;[26] and (c) capable of having an effect in the UK.[27] The FPR applies to communications that a person makes, or 'causes to be made',[28] (i.e. both itself, or through an agent). A communication that meets those conditions will breach the FPR unless it is made or approved by a UK authorised person.[29] Breach of the FPR is a criminal offence.[30] The civil consequences[31] of that offence (including the potential un-enforceability of the contract against the customer) are similar to the consequences of breaching the general prohibition in FSMA 2000, s. 19. Put another way, an important part of the force of the FPR is that it gives a UK customer a way out of a contract entered into following a communication made in breach of the FPR, as well as the right to recover compensation.

23 European Commission Interpretative Communication 2000/C43/03, p. 8.
24 See Financial Services Authority v. Fradley and Woodward [2005] EWCA 1183, per. Arden LJ at [53].
25 Note that this decision was overturned on appeal in Re a company (No 007816 of 1994) [1997] 2 BCLC 685 (CA), but the principle cited was not criticised.
26 FSMA 2000, s. 21(1).
27 FSMA 2000, s. 21(3).
28 FSMA 2000, s. 21(13).
29 FSMA 2000, s. 21(2).
30 FSMA 2000, s. 25.
31 FSMA 2000, s. 30.

The detailed scope of the FCR is set out in the Financial Services and Markets Act 2000 (Financial Promotion) Order 2005 (SI 2005/1529) ('the FPO'), which creates a complex network of definitions, inclusions and exceptions, the application of which is almost always fact-specific.

Application of the FPR to promotions of insurance business

Given the complexity of the FPR, a prudent insurer will obtain specialist advice to determine whether or not the FPR applies to proposed communication in or into the UK. In broad outline, however, the FPR does not apply to (a) generic promotions that do not identify an insurer;[32] (b) non-real-time communications about contracts of insurance that are not 'life policies',[33] provided that the communication includes specified information about the insurer;[34] (c) communications about reinsurance and the insurance of large risks;[35] and (d) real-time communications about contracts of insurance that are not life policies.[36] Correspondingly, the promotion of foreign life policies is prohibited.[37]

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32 FPO, Art. 17.

33 Broadly, a contract of long-term insurance that is neither (a) reinsurance; nor (b) a pure protection policy (e.g. without a surrender value). See FPO, Schedule 1, ¶ 21, read with the FPO, Art. 2 and the RAO, Art. 3.

34 FPO, Art. 24.

35 FPO, Art. 25.

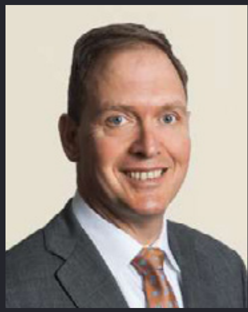
36 FPO, Art. 26.

37 FPO, Art. 10.

Three Verulam Buildings Barristers

Robert Purves

Author



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