LONDON MARKET GROUP

PROPOSALS FOR A FUTURE TRADING RELATIONSHIP BETWEEN THE EU AND UK
The London Insurance Market leads the world in providing specialty commercial insurance and reinsurance, taking on the most difficult and complicated risks. The London Market Group (LMG) represents the four key market constituents - the International Underwriting Association of London (IUA), Lloyd’s, the Lloyd’s Market Association (LMA) and the London & International Insurance Brokers’ Association (LIIBA). These bodies in turn represent companies that generate over 26% of the City of London’s total income, employing 52,000 people and controlling over $90 billion of revenue.

The LMG is the only body which speaks collectively for all practitioners in this significant market, representing the views of insurance brokers, those insurers and reinsurers operating within Lloyd’s, and branches of overseas insurers and reinsurers operating in London – reflecting the full extent of the Market.

FURTHER INFORMATION

We would be very happy to discuss any aspect of this document. Please contact Chief Executive, Christopher Beazley on 020 7327 5293 or email christopher.beazley@londonmarketgroup.co.uk
## CONTENTS

<table>
<thead>
<tr>
<th>Section</th>
<th>Page</th>
</tr>
</thead>
<tbody>
<tr>
<td>SUMMARY</td>
<td>3</td>
</tr>
<tr>
<td>HOW THE LONDON INSURANCE MARKET OPERATES</td>
<td>5</td>
</tr>
<tr>
<td>THE LONDON MARKET GROUP PROPOSALS</td>
<td>6</td>
</tr>
<tr>
<td>A FREE TRADE AGREEMENT THAT BENEFITS CLIENTS</td>
<td>8</td>
</tr>
<tr>
<td>A TRANSITION PERIOD TO MAINTAIN CLIENT ACCESS</td>
<td>9</td>
</tr>
<tr>
<td>A SOLUTION THAT WORKS FOR EU AND UK CLIENTS AND BUSINESSES</td>
<td>11</td>
</tr>
<tr>
<td>OVERCOMING THE REGULATORY CHALLENGES FOR BUSINESSES OPERATING IN THE MARKET</td>
<td>13</td>
</tr>
<tr>
<td>CRITICAL BUSINESS DECISIONS FOR THE INDUSTRY</td>
<td>14</td>
</tr>
<tr>
<td>TRANSITION AGREEMENT PROPOSALS</td>
<td>16</td>
</tr>
<tr>
<td>EXISTING AGREEMENTS AND PRECEDENTS</td>
<td>17</td>
</tr>
<tr>
<td>APPENDIX</td>
<td>18</td>
</tr>
<tr>
<td>ACKNOWLEDGEMENTS</td>
<td>21</td>
</tr>
</tbody>
</table>
THE LONDON INSURANCE MARKET IS THE TRADING CENTRE FOR GLOBAL INSURANCE AND REINSURANCE RISKS

<table>
<thead>
<tr>
<th>❑ 26% CITY OF LONDON GDP</th>
<th>🔈 US$90 BILLION (RE)INSURANCE PREMIUMS</th>
</tr>
</thead>
<tbody>
<tr>
<td>❑ 52,000 EMPLOYEES</td>
<td>❑ 52% MARKET SHARE - ENERGY</td>
</tr>
<tr>
<td>❑ 17,000 OUTSIDE LONDON</td>
<td>❑ £8BN COVERS EU* RISKS</td>
</tr>
<tr>
<td>❑ 2,400 EU NATIONALS</td>
<td>❑ 33% MARKET SHARE - MARINE</td>
</tr>
<tr>
<td></td>
<td>❑ £6BN WRITTEN VIA (RE)INNSURERS WITH PARENT OR COMPANY IN EU</td>
</tr>
<tr>
<td></td>
<td>❑ 60% MARKET SHARE - AVIATION</td>
</tr>
<tr>
<td></td>
<td>❑ PROVIDES COVERAGE ACROSS MORE THAN 200 COUNTRIES</td>
</tr>
</tbody>
</table>

* Please note that when this report refers to the European Union (EU), it also refers to those countries who are members of the European Economic Area (EEA), recognising that the negotiation is between the UK and the EU, with the EEA states bound by whatever agreement is ultimately reached.
SUMMARY

The London Market Group (LMG) is proud of the contribution that the London Insurance Market is able to play in supporting EU business and facilitating the flow of trade and commerce across the EU. The LMG wants this special trading partnership to endure and grow, ensuring that risks are effectively pooled across the UK and EU markets and that clients can maintain their access to a broad range of insurance services, expertise and capacity. Clients should not be left in a situation where there is contractual uncertainty and protection gaps.

The London Insurance Market is the global centre of specialty insurance and reinsurance, an ecosystem comprising brokers*, insurance and reinsurance companies, together with Lloyd’s members, managing agents and syndicates, supported through central trading and processing systems, and specialist support providers.

- Its unique subscription market and qualities of concentrated capital, expertise and ability to provide global coverage ensure that London is relied upon by many clients in the EU as the best place capable of undertaking certain types of insurance and reinsurance business.
- Currently over £8 billion of premium is brought annually to the London Insurance Market by brokers on behalf of EU clients.
- Over £6 billion of international business is written in London by firms with a parent company or principal base located elsewhere in the EU, demonstrating the importance of continuing mutual market access between the EU and UK post-Brexit.
- The Market is responsible for $90 billion (re)insurance business, via over 350 firms and with business derived from over 200 countries.
- The Market is bigger than all its nearest rivals combined - Zurich, Bermuda and Singapore - and has over 60% and 52% market share of the global aviation and energy markets respectively, and over one third of the marine market.

Understandably Brexit raises significant issues and challenges for the ecosystem that constitutes the London Insurance Market, including specific concerns among EU clients about their future access to its services.

In addition, this is creating uncertainty in their minds over the settlement of claims and the continuity of their cover in future years. Whatever the outcome of the negotiations, the final withdrawal agreement from the EU must contain a provision that there will be no legal barriers in the UK or EU to the fulfilment of (re)insurance contracts entered into prior to Brexit.

*When this report refers to brokers, it is also referring to intermediaries, the agents of a customer as well as entities acting under delegated authority.
Within this context, the LMG has considered various approaches to preserving the Market ecosystem, and potential arrangements between the EU and UK post-Brexit, and has reached the following conclusions:

1. For EU clients to continue to benefit from the unique coverage available in London, a bespoke Free Trade Agreement (FTA) is required which provides for mutual market access and recognition of prudential regimes on the basis of a regulatory alignment model between the UK and the EU;

2. To ensure that there is no interruption in our ability to provide our unique insurance offering to EU clients, a transition period is needed, which maintains the existing trading status quo and is agreed at the start of the negotiating process through to when the FTA is implemented;

3. To ensure that there is no danger of the London Insurance Market being unable to fulfil its commitments to EU clients, the withdrawal agreement from the EU must contain a provision that there will be no legal barriers in the UK or EU, to the fulfilment of (re)insurance contracts entered into prior to Brexit; and

4. Regulatory equivalence under Solvency II alone will not address the expected disruption experienced by EU clients and businesses in accessing the London Insurance Market. The relevant legislation does not contain the necessary equivalence regimes or scope to establish their market access.

This paper identifies the key criteria for a FTA and a transition period to preserve the effective operation of the London Insurance Market through Brexit. It also highlights the critical milestones and timeline for the FTA and transition period, as well as the risks and impacts should a FTA not be forthcoming, including the disruptive effects of potential alternative approaches on the Market.
HOW THE LONDON INSURANCE MARKET OPERATES

In transacting business between the EU27 and UK, a series of intertwined EU Directives enable business to flow:

- **Solvency II**: The Directive provides a prudential risk-based solvency regime for (re)insurers providing maximum harmonisation across the EU and prescribing authorisation, mutual market access (through passports on an establishment and cross border services basis), based on home state regulation and supervision. 

  Solvency II includes very limited equivalence provisions aimed at ensuring there are no penalties for business ceded to equivalent reinsurers, and minimising regulatory overlays for (re)insurers subject to group supervision. **Solvency II equivalence does not provide for direct market access.**

- **Insurance Distribution Directive** (replacing the Insurance Mediation Directive (IMD) from 2018): The Directive provides a minimum harmonisation regime providing a prudential regime for brokers and prescribing a conduct regime for all (insurance and broker) distributors. Again, it provides for mutual market access via passport rights. **However, unlike Solvency II, the Directive has no equivalence regime and no third country branch regime.**

These core Directives are supplemented by a number of other EU Directives and Regulations in order to capture the full ambit of business e.g. distance sales (Distance Marketing Directive), data protection (General Data Protection Regulations from May 2018) and, e-commerce (E-Commerce Directive).

Firms also benefit from Directives such as the Cross-Border Mergers Directive, the Tax Mergers Directive, and the Societas Europea Directives which allow them to change the structure of their businesses across the EU.

Further analysis on how the Market operates can be found in the Appendix to this report.

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**Regulatory equivalence under Solvency II alone will not address the disruption that clients and businesses will face on Brexit.**

**A bespoke Free Trade Agreement and a complementary transition period are required to preserve the ability of the London Insurance Market to deliver benefit to EU clients through Brexit.**
There are a number of possible options and outcomes for a UK-EU FTA and a transition period for the London Insurance Market.

This will involve leveraging Solvency II for (re)insurers, and the Insurance Distribution Directive for brokers, as the two main EU Directives providing market access, regulatory requirements and supervision for firms operating in the Market.

In negotiating Brexit arrangements for the Market, it should be noted that:

- Standalone Solvency II equivalence will not of itself address the disruption to the Market as a result of Brexit.
- The structure and terms of a negotiated FTA, and how the FTA interfaces with the transition period, are crucial in preserving the ability of EU clients to continue to benefit from the unique coverage and expertise available in London, as well as ensuring the most effective operation of the Market.

There are three core elements to the LMG’s proposals:

- **A Free Trade Agreement:** A bespoke Mutual Recognition Agreement which delivers mutual market access, recognition of prudential regimes, with a Solvency II equivalence outcome built into the agreement and supervisory cooperation based on a regulatory alignment model for prudential regulation of (re)insurers and brokers. A Consent to Jurisdiction approach is proposed for conduct regulation.

  The FTA must also provide clarity that as part of a smooth transition into this new agreement, that there will be no impediments to paying claims in relation to business written prior to the end of the transition period. If this cannot be agreed as part of the FTA, a bespoke contract certainty clause, or grandfathering of licenses during the transition period, must be agreed so that EU clients continue to have contractual certainty.

- **A transition period:** This would maintain the trading status quo, through to such time as a FTA is agreed and implemented, thereby avoiding a double cliff edge for clients.

- **The Withdrawal Agreement:** The Withdrawal Agreement must contain a provision that there will be no legal barriers in the UK or EU, to the fulfilment of (re)insurance contracts entered into prior to the UK withdrawing from the EU. This will provide the necessary certainty for EU clients that their existing contracts will continue to be enforced and that claims will be paid.
The benefits of the LMG’s proposal are:

- It will allow EU consumers and businesses to access London’s breadth of expertise and specialist risk capacity. In some instances, this is insurance that would not be available in other insurance centres. This has a knock-on effect in that it will continue to facilitate the wider economic activity in EU member states driven by those consumers and businesses;
- It supports EU and UK clients, people and businesses by avoiding the global financial impact that fragmentation of the insurance market could elicit;
- It provides for the EU and UK to leverage each other’s regimes giving the EU flexibility as well as the scope for compensating regulation and supervision, ensuring that the agreement would have longevity; and
- It gives EU (re)insurance businesses with a presence in the UK and UK (re)insurance companies operating in Europe time to make informed decisions based on the new FTA, which will ultimately benefit their clients.

This proposal is not only preferable, it also uniquely serves to retain the integrity of the London Insurance Market and avoid a disruptive transition for all the Market’s clients and businesses across the EU and UK.
A FREE TRADE AGREEMENT THAT BENEFITS CLIENTS

By agreeing a bespoke FTA that provides for mutual market access, EU clients will continue to benefit from the unique coverage available in London.

The key attributes of LMG’s FTA proposal are:

1. Mutual market access for (re)insurers and brokers (Regulatory alignment model) – This would provide the ability for (re)insurance business to be underwritten, and for (re)insurance transactions to flow freely between the EU and UK; specifically, for EU and UK (re)insurers and brokers to continue to access each other’s markets efficiently through the provision of cross border services and local establishments.
   - **For (re)insurers** – Mutual market access allowing (re)insurers to operate freely on the basis of establishments within, and cross border services between, the EU and UK, and to underwrite risks in each other’s jurisdiction through a recognition of each party’s prudential regime.
   - **For brokers** – Mutual market access allowing EU and UK (re)insurance brokers to access each other’s market and for transactions to flow freely between the EU and UK. Such access is currently provided under the Insurance Mediation Directive (IMD); in 2018 this is due to be replaced by the Insurance Distribution Directive (IDD).

2. Recognition of prudential regimes for (re)insurers and brokers (Regulatory alignment model) – Acknowledging the EU and UK prudential requirements for (re)insurers and brokers, underpinning mutual market access, avoiding unnecessary burdens for firms and supervisory duplication.

3. A level playing field for groups and reinsurers (Regulatory alignment model) – This would be founded on the recognition of EU and UK prudential regimes:
   - **A level playing field for reinsurance** – The FTA would implicitly through mutual market access recognise the EU and UK prudential regimes (under Solvency II) for reinsurance and provide a level playing field to ensure that EU and UK reinsurance markets operate efficiently without restriction or additional costs on reinsurance business placed by UK or EU cedants with EU and UK reinsurers, respectively. This would have the effect of replicating the existing reinsurance equivalence under Solvency II.
   - **A level playing field for EU and UK (re)insurance groups** – The FTA should ensure that EU and UK (re)insurance firms/groups are not negatively affected by regulatory duplication and frictional supervisory costs. This would have the effect of replicating the existing group supervision and solo supervision equivalence under Solvency II.

4. Allowance for future developments for prudential regimes (Regulatory alignment model) – Where divergences exist or could occur in future, and where these affect the recognition of licensing and prudential regulation, the FTA should provide scope for appropriate additional prudential requirements and supervisory cooperation, i.e. through a divergence framework/prudential carve out.

5. Recognising local market practices for conduct (Consent to Jurisdiction model) – This would acknowledge that the regulation of the conduct of business, whilst operating under a common set of principles, is generally domicile specific due to local market structures, cultural practices, and government policy. The FTA should allow EU and UK firms to conduct business freely throughout the EU and UK on the basis that each complies with the local jurisdiction requirements, applicable to the distribution and conduct of business.
A TRANSITION PERIOD TO MAINTAIN CLIENT ACCESS

A period of time is needed that allows for the continuation of EU and UK clients’ and businesses’ existing market access rights and current supervisory arrangements.

This transition period should provide for the London Insurance Market to operate as if EU status is preserved, which would benefit EU businesses operating within the UK and vice versa, until such time as the FTA is agreed and with sufficient time for the Market to reshape in line with the FTA outcomes.

This would preserve the Market’s ecosystem and give all the London Insurance Market’s EU and multinational clients the certainty they require and it would enable the London Insurance Market to continue to provide clients with both multi-territory policies and global wholesale insurance covering EU risks, all from the same location. Early agreement of a transition period and the retention of market access rights during this time until the new FTA comes into force, could also remove the need for EU businesses with a presence in the UK and UK businesses with a presence in the EU, to reorganise before they know the detail of the new relationship.

The priorities for achieving a smooth transition to Brexit are:

- **Maintaining client service** - This will allow businesses to best support clients and to consider the most effective post-Brexit approach to serving clients once the FTA is known.

- **Contractual certainty for clients, where business is transitioning to new UK-EU models** - On the basis a transition period should support delivery of contract certainty for continuing business migrating from the pre-Brexit to post-Brexit environment.

- **Contractual certainty for business already in run off at the time of Brexit and being discontinued thereafter** (depending on the FTA)* - Legal fulfilment risks remain for legacy run off portfolios and should be provided as a pre-requisite to avoid EU policyholder uncertainty, ensure efficient fulfilment of existing obligations by firms, and avoid additional costs of firms having to license new entities (which may not be viable).

- **Avoiding a double cliff edge for clients** - If a transition period is not agreed that extends over both the time from Brexit (March 2019) until such time the FTA is agreed, and additionally allowing for time for the Market to effectively adapt to the post-Brexit environment, then there is a risk of a double cliff edge and a disorderly transition, causing extensive disruption for EU clients and financial instability. The potential double cliff edge is firstly at the Brexit date in the event of no agreement, and secondly where a new trade deal is negotiated without sufficient time for the Market to reorganise.

- **Ensuring an orderly transition** - The benefit of such an arrangement is that it means EU (re)insurers and brokers will have sufficient time to transition in an orderly manner and secure certainty for EU and UK clients.

- **Removing the pressure to make critical decisions to move business prematurely prior to clarity on the final Brexit outcome becoming known** - It will be important to ensure EU and UK firms are not forced into premature decisions prior to Brexit being agreed and which may not be most effective for clients, personnel, the business and the wider market ecosystem. The regulatory process for an insurer to restructure its business typically takes a minimum of a year to 18 months to complete in normal circumstances, therefore business decisions will need to be finalised soon.

*If this cannot be agreed as part of the FTA, a bespoke contract certainty clause, or a grandfathering of licenses during the transition period must be agreed so that EU clients have some certainty.
The transition period must be agreed by the end of 2017 and at least 12 months before Brexit, since businesses in the Market face critical decisions to progress with applications and approvals to avoid contract certainty risk for their clients and to secure the future viability of their business in the event of no agreement being reached by March 2019.

Agreeing an effective transition period will give certainty for clients and ensure sufficient time for businesses to make informed decisions once the FTA outcome is known. (See pages 18-19 below for further details).
Restrictions on business transactions between the EU and UK, arising as a result of Brexit, have significant consequences for EU clients. A broad range of EU based businesses often undertaking activities critical to the EU economy require specialist cover from the London Insurance Market.

Without continued access there will be market disruption and dislocation in a range of sectors including, aviation, marine, satellite communications, ship building, nuclear power and energy infrastructure, deep sea cabling and tunnelling. The LMG wants to see this flow of trade continue so that EU and UK business can continue to access the expertise and capital that the London Insurance Market can offer.

The proposed FTA and transition period outlined above address the challenges that those EU and UK clients and businesses are likely to face on Brexit:

**BREXIT RISKS FOR CLIENTS**

**Significant capacity restrictions leading to less choice for EU clients and protection gaps**

- **Sustainability and discontinued lines** - The additional costs and inefficiencies associated with separate UK/EU subsidiaries will raise sustainability concerns, with some UK (re)insurers potentially needing to discontinue lines of business for EU clients.

- **Capacity constraints** - Restrictions on business flows between the EU and UK (under both Solvency II for (re)insurers, and the Insurance Distribution Directive for brokers), for EU and international placements means there is a risk of insufficient capacity to underwrite certain specialist risks ordinarily written via the London Insurance Market on a subscription basis.

- **Consolidation and policyholder choice** - The structural changes resulting from Brexit have potential implications for the broader competitive landscape, both within the EU and UK as a result of inefficiencies and consolidation of portfolios leading to less choice for EU and UK clients.

**Increased cost of cover for EU clients resulting from reduced capacity through increased capital, operating and compliance costs**

- **Higher capital and compliance costs** - In the absence of continued market access, should EU and UK (re)insurers and brokers be required to separately subsidiarise their operations, this would inevitably lead to increased capital requirements, and undermine the benefits of diversification possible through branch arrangements under Solvency II. There would also be additional costs associated with two regulated entities, separately supervised.

- **Additional inefficiencies and costs for reinsurance** - These would arise for insurers who had passed on risks to reinsurers (cedant businesses), in the form of potential collateral costs and solvency capital charges, if the level playing field afforded through equivalence is not retained post-Brexit.
More complexity affects policyholders’ ability to transact seamlessly for UK-EU coverages, firms’ and supervisors’ efficiency

- **Policy coverage and security** - Client coverage will be more complex if separate UK-EU policies are needed and may result in different security, depending on the balance sheet size for split EU-UK business.

- **Governance and operational complexities and overlays introduce risk** - If firms need to establish separate UK and EU subsidiaries, this will introduce governance and operational complexities as a result of more overlapping structures, in order to leverage systems and expertise in the UK/EU home state.

- **Regulatory requirements to monitor (and potentially limit) outsourcing may lead to standalone capability in each of the EU and UK operations, increasing the need for greater resources and therefore costs (including relocation) and inefficiencies** - For example the EU insurance regulator, EIOPA has already indicated it is monitoring the use of matrix and back-to-back models.

- **Increased supervisory burden and complexity** - Simultaneously this will heighten the complications of prudential supervision for (re)insurers and brokers with UK and EU operations, and group supervision for (re)insurers under Solvency II.

**Meeting these risks:**
All of these risks can are addressed through the LMG’s FTA proposal, providing mutual market access rights and recognition of prudential regimes.
OVERCOMING THE REGULATORY CHALLENGES FOR BUSINESSES OPERATING IN THE MARKET

Brexit also has a range of potential regulatory implications for UK, EU and global insurance and reinsurance businesses within the London Insurance Market operating between the UK and EU.

LMG’s proposals for a bespoke FTA and a complementary transition period also address these challenges.

- **Restrictions on the ability of UK-EU (re)insurers to underwrite risks on a cross border basis and through local establishments** – Potentially requiring the establishment of locally domiciled subsidiaries. (See previous page for more details).

- **Penalties for UK reinsurers writing EU cedant reinsurance** – These could take the form of collateral requirements, making UK reinsurers less attractive for business, as well as difficulties in accessing certain EU reinsurance markets.

- **Duplicative group supervision and group solvency capital burdens** - Where (re)insurance groups contain UK and EU reinsurers.

- **Restrictions on transaction flows between the UK-EU and vice versa** - Potentially impacting the ability of brokers to arrange placements between network firms and requiring flows via EU brokers only, thus preventing access for EU clients to the London Insurance Market (and vice versa).

- **Contract certainty and fulfilment of claims** - Differences in the regulated activities and licensing requirements within EU member states, coupled with the time needed to move portfolios, risks affecting the ability to legally settle claims. This is a key issue which also potentially impacts firms in run-off including long term life and pensions business.

This is addressed through FTA mutual access rights under Solvency II.

This is addressed through FTA Solvency II reinsurance equivalence outcomes.

This is addressed through FTA Solvency II group supervision and solo solvency equivalence outcomes.

This is addressed through the FTA mutual access rights under IDD.

This is dealt with through a Contract Certainty clause in the Withdrawal Agreement and mutual market access in FTA extending to run off, and transition period.
CRITICAL BUSINESS DECISIONS FOR THE INDUSTRY

If no FTA and transition period can be agreed, trading under WTO Rules would have profound implications for the London Insurance Market and its clients, requiring EU firms to restructure if they wish to continue trading in the UK and vice versa for UK firms needing to move components of their business to the EU.

This option poses a medium-term threat to the clustering of expertise within London’s insurance ecosystem which currently provides UK, EU and global clients with access to concentrated capital, expertise as well as the ability to secure global coverage in one place.

This would have a number of consequences:

- It would undermine the Market’s successful model of centralisation of capital and expertise.
- It is expected that many entities in London would no longer do business in certain EU states, harming the ability of many EU clients to secure the necessary coverage; likewise, EU firms may cease to have a presence in the London Insurance Market.
- Capital and cost inefficiencies, coupled with capacity consequences, and the need to split policies covering both UK and EU risks could lead to price rises creating additional and potentially unsustainable costs for EU clients.

In this scenario, the industry’s hands would be tied. It would have no choice but to restructure given the restrictive nature of many member states’ market access rules for non-EU insurers and reinsurers. It is not legally possible to write EU business from the UK (and vice versa) under WTO Rules. In order to continue to legally service their clients, companies will be forced to create separate subsidiaries.

This gives rise to a number of critical considerations for firms in planning and executing the transition to a viable post-Brexit structure.

Transitioning to new UK-EU business models involving restructuring and re-domesticating (re)insurance business, and establishing new operations, is complex and time-consuming. There is a risk that firms will not be able to complete the transition pre-Brexit.

- There is a contract certainty risk since re-domesticating portfolios can take well over a year to 18 months and in the event of a backlog in approvals as the Market shifts, there is a risk of firms not completing by March 2019, thus creating contract certainty risks for clients.

- Firms may be forced to make final decisions and transition early to de-risk, if no FTA or transition period is clarified in the short term. Extensive time is needed to secure the multiple approvals from regulators, Works Councils, tax authorities as well as legal steps and court hearings drawing on various local jurisdiction requirements and EU Directives. Alongside this, there will be a need for businesses re-domesticating to establish local EU or UK governance, systems and data considerations including compliance with the EU’s General Data Protection...
Regulations (GDPR), local accounting and compliance requirements, as well as transitioning people, clients and insurer/broker relationships.

- **There are a range of regulations involved in the transition beyond core insurance directives.** Firms will need access during the transition period to Directives such as the Cross-Border Mergers Directive, the Tax Mergers Directive, the Societas Europea Directives (and many more) to enable a legal transition to the post-Brexit model if UK businesses are required to be re-domesticated to within the EU (and vice versa).

The diagram below sets out the critical path for clients and businesses operating within the London Insurance Market and when key decisions will need to be taken on activating their restructuring plans set out above.

### Critical path

**Brexit plan dates**

- **DEC 2017**
  - Q1 2018 – latest date for certainty for transferring UK business to a EU subsidiary
  - Transition period agreed

- **APR 2018**
  - Q2 2018 – latest date for certainty for application for authorisation of new EU subsidiary (requires 6 months)

- **JUN 2018**

- **SEPT 2018**

- **DEC 2018**
  - Jan 2019 – underwriting goes live

- **APR 2019**

- **ONWARDS**

### Market factors

- **Transition period agreed**
- **Client placements 1 year ahead of Brexit – contract certainty risk**
- **2019 renewal season Sept 2018 – licence required/contract certainty risk**

**Market adjusts depending on terms of FTA. The LMG proposals would require minimal adjustment to business models.**
# TRANSITION AGREEMENT PROPOSALS

## Overview of interface between Free Trade Agreement and transition period

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<thead>
<tr>
<th>Brexit FTA outcome description</th>
<th>Time for FTA to be developed and effective</th>
<th>Adjustment period</th>
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<tbody>
<tr>
<td><strong>FTA – ALIGNMENT MODEL FOR PRUDENTIAL, CONSENT TO JURISDICTION FOR CONDUCT</strong></td>
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### FTA Bespoke Solvency II
- mutual market access, prudential regime recognition, supervisory cooperation and equivalence outcome based on alignment.

- **ARTICLE 50** (March 2019)

  Treatment for UK as EU status during transition period (reciprocated for EU firms)

### FTA Bespoke IDD
- mutual market access, prudential supervision based on alignment for brokers, Consent to jurisdiction for all conduct, permitted transaction flows UK-EU and EU-UK.

- The period to negotiate and agree the FTA may take time to agree.

  If the FTA operates as prescribed then business would continue as usual with minor adjustments to regulation and supervision between the UK and EU. This would avoid restructuring and contract certainty risk for those continuing business.

  Contract certainty for all discontinued and run off business up to withdrawal, would need to be addressed in the FTA or transition period to avoid those businesses having to undergo new licensing arrangements.

Note: Adjustment period involving restructuring will require the full suite of enabling EU legislation – Cross-Border Mergers Directive, Tax Mergers Directive, Societas Europea Directive, etc.
EXISTING AGREEMENTS AND PRECEDENTS

There are a number of international agreements that seek to reduce non-tariff barriers for insurance and reinsurance services. These include the recently concluded US - EU Covered Agreement on prudential measures regarding insurance and reinsurance and the Bilateral Agreement between Switzerland and the EU for non-life insurers.

While these two agreements would not on their own provide the access that the UK commercial insurance market requires, for example neither provides cross-border access, there are elements within each of them which could be useful precedents.

The table below sets out some of the elements to note within these agreements. In addition to those cited in the table, LMG continues to consider a range of other potential international precedents for a new UK - EU FTA.

<table>
<thead>
<tr>
<th>Agreement</th>
<th>Measures to note</th>
<th>Issues the Agreement does not cover</th>
</tr>
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<tbody>
<tr>
<td>US - EU Covered Agreement¹</td>
<td><strong>Removes capital requirements:</strong> The removal of the need for discriminatory statutory collateral and local presence requirements for US and EU reinsurers operating in each other’s markets.</td>
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<td><strong>Recognises home group supervision:</strong> US and EU insurance groups operating in each other’s markets are subject to the worldwide prudential group oversight of supervisors in their home jurisdiction only.</td>
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<td><strong>Regulatory cooperation:</strong> Insurance regulatory authorities in the US and the EU are encouraged to continue to exchange supervisory information on insurers and reinsurers that operate in both markets, facilitating supervision of insurance groups and home state supervision.</td>
<td>The Agreement does not cover direct market access rights for insurers.</td>
</tr>
<tr>
<td>Bilateral Agreement between Switzerland and the EU for non-life insurance²</td>
<td><strong>Reduces capital requirements:</strong> It limits capital requirements to the possession of a minimum guarantee fund or a minimum solvency margin.</td>
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<td></td>
<td><strong>Home state supervision on capital:</strong> It enables the EU supervisor of a branch of a Swiss non-life insurer in the EU to allow the Swiss supervisor to calculate its capital requirement according to Swiss rules, and vice versa.</td>
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<td><strong>Provides a mechanism to influence regulation and arbitration:</strong> A joint committee composed of representatives from Switzerland and the EU administer the Agreement, it also includes an arbitration process in the case of any disputes.</td>
<td>The cross-border offering of insurance to Europe from Switzerland is not permitted. A branch is still required in an EU country. Insurers must have personnel in the respective EU countries.</td>
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¹ Bilateral Agreement between the European Union and the United States of America on Prudential Measures Regarding Insurance and Reinsurance, 2017 (Covered Agreement)

² Agreement between the European Economic Community and the Swiss Confederation on direct insurance other than life assurance, 1993
TRANSACTION FLOWS FOR LONDON MARKET WITH EU27 CLIENT IN RESPECT OF EU RISKS

Currently, the EU regime allows EU risks to be placed and underwritten cross-border by brokers and reinsurers under home state supervision.

Step 1. EU27 Client to EU producing broker – Client explains requirements to producing broker.
IMD (and from Feb 18, ICQ) applies. Also, local law based on IMD/ICQ applies.

Step 2. EU27 producing broker to UK broker – producing broker seeks cross border services from UK broker to structure the client’s risk placement and select insurer(s) or EU27 broker goes direct to UK insurer(s).
As well as brokers, ICQ extends to cover insurance undertakings that sell directly to customers.

Step 3. UK broker to UK insurer – UK broker structures EU27 client risks and places business with UK insurer in the London Market.
Solvency II Directive 2009/138/EC currently provides UK based insurers with ability to write EU27 risks.

Step 4. The UK insurer to broker – the UK insurer passes the agreed policies back to the broker.

Step 5. The broker passes the policies back through the chain of intermediaries and producing broker to the client.
Any changes to the in-force policy are then passed through steps 1 – 5.

Step 6. UK insurer to reinsurance broker
If reinsurance broker is EU27 based (not UK), then they will be relying on an inbound passport under Freedom of Services.
IMD/ICQ challenges apply (see Step 2 above).

Step 7. UK Reinsurer to EU insurer
Solvency II Directive 2009/138/EC
Allows reinsurers services to operate across EU borders and is crucial in allowing reinsurance business to be transacted across EU borders.

Insured:
Clients’ needs are usually highly complex and specific. They need cover for large and complex risks, which presents major challenges in getting the right policies.
Clients are also regularly introducing large losses into the market requiring significant capital resources and support. Often a client will require full market capacity, i.e. many London Market players will have some of the risk.
Local markets within the EU27 do not have the capital resource or specialist skills available to structure and underwrite these large and complex risks.

Brokering broker:
The producing broker is closest to the client, they are either an EU27 based independent broker or a EU branch of a global broker. They work with the client to discuss their specific requirements. When clients have a large, complex or specialist risk they are likely to require access to international markets, most notably the London Market to fully insure these risks. EU27 markets alone could not adequately cover these kinds of risk.
They will come to London, whether a local EU27 broker or a global broker, often with the client, to discuss their broad portfolio of needs. The complexity of the negotiating process necessitates discussions between clients, brokers and carriers in person. The geographic proximity of carriers within the London insurance cluster also facilitates multiple meetings with multiple carriers within a single visit.

Wholesale broker/Lloyd’s broker:
These are specialist brokers based in the London Market who work on a cross border basis with the producing broker to expertly structure the risk within the market and find the underwriting capacity in the market to place the client’s risk.
They take the details from the producing broker and utilise their knowledge of the London Market to negotiate quotes and contract terms and conditions from insurers. Given the capital required, often this is a combination of London Market and other international insurance centres.
A key feature of the London Market is its capacity to structure multi-national policies. Typically for clients with operations and risks covering multiple territories. London Market firms have specialist teams to structure these policies, manage policy issuance and manage highly complex claims.
No other insurance market in the world can offer this level of expertise to EU clients, resulting in substantial benefits to EU clients in terms of competitive pricing and breadth of coverage.

Insurers:
London Market insurers specialise in underwriting specific classes of commercial risk. These insurers often underwrite such business on a subscription basis – where each insurer takes only a proportion of the risk, facilitated by a framework of established protocols to ensure efficient delivery to the client.
It is the only such market in the world and this is the mechanism that allows London to write risks that are either too large or too complex for other insurance centres. The Market contains world class expertise in developing and managing large and complex policies on issues such as marine, energy, large scale construction and infrastructure, standard property and casualty, terrorism and cyber security. This also includes expertise in loss adjusting and claims management. Expertise which is simply not available to EU clients in other markets.
The clients’ risks are often packaged into multiple, integrated policies across jurisdictions. Only London Market carriers can provide this kind of tailored, bespoke coverage.

Reinsurance broker:
This broker works with insurers to take on the proportion of their “direct” insurance to reinsurers on an annual or one off basis. They require a wider geographic knowledge than the wholesale broker due to the need to dispose risk away from London.

Reinsurers:
Reinsurers issue other insures. London specialist insurers rely upon support of reinsurers to provide the capacity required by EU clients.
Significant amounts of reinsurance business is undertaken in London but due to the ease of transactions flows, business tends to flow back to the parent company balance sheet and tends not be held in UK branches.
**FREE TRADE AGREEMENT PROPOSALS FOR THE LONDON INSURANCE MARKET**

Overview of the proposed Free Trade Agreement for Solvency II

**INSURERS & REINSURERS**

Solvency II (maximum harmonisation) provides:

1. Authorisation and prudential regulation of insurers and reinsurers.
2. Mutual market access for establishment (branch) and services for EU firms.
3. Equivalence for third country groups, reinsurance and solo solvency.
4. Third country branch regime on a discretionary basis.
5. Ability for bilateral.

**Proposed FTA approach for**

1. Market access
2. Prudential regime
3. Supervisory cooperation
4. Equivalence outcome

Bilateral agreement on the basis of regulatory alignment giving effect to:

- Mutual market access based on home regulator approval.
- Full recognition of prudential supervision (i.e. No local governance, risk, capital or reporting requirements).
- Full supervisory cooperation e.g. mutual college participation, information sharing bilateral cooperation with EU member state supervisors.
- An Equivalence outcome (implicit in prudential recognition).
- A divergence framework.

Relative merits of proposals

- Focuses on outcomes and does not tie UK or EU into mirroring each other’s regimes.
- Provides mutual market access, prudential supervision, equivalence certainty – all on the basis of home state supervision.
- The agreement may need to incorporate arrangements to address specific nuances regarding the protection of local policyholders within a third country branch structure – for example supervisor approaches regarding recovery and resolution situations, and associated capital and reporting considerations.
- More bespoke by reference to Solvency II and therefore can be drafted so as to be capable of adapting to Solvency II and UK regime change, just flexing the regime leverage and providing for additional regulation/supervision to accommodate.
- Builds on approach taken within the US-EU Covered Agreement and supports potential for other global FTAs.

Meets criteria

Supports business models

![H](#)  ![H](#)  ![H](#)  ![H](#)  ![H](#)

**Overall rating of FTA option:**

- **Longevity/certainty – no short-term risks**
- **Flexibility to adapt to regime changes**
- **Level playing field (Equivalence)**
- **UK-EU transaction flows (IDD Art 16)**
- **Market access (re)insurer (I) and broker (B)**

H M L – effectiveness measure/score
FREE TRADE AGREEMENT PROPOSALS FOR THE LONDON INSURANCE MARKET
Overview of Free Trade Agreement for Insurance Distribution Directive

BROKERS (PLUS INSURER CONDUCT)

Insurance Distribution Directive 2018 (Minimum harmonisation) providing:

1. Licensing and prudential regulation of insurance and reinsurance brokers.
2. Mutual market access for establishment (branch) and services for EU firms.
3. Conduct requirements for distributors (insurer/broker).
4. No equivalence.
5. No third country regime.
6. Ability for bilateral.

Insurance Distribution Directive – A FTA providing mutual recognition for EU/UK access, prudential supervision based on agreed regulatory alignment for prudential aspects and consent to jurisdiction for conduct – transaction flows UK-EU and EU-UK are implicit (Art 16 IDD)

Mutual access preserved akin to passporting, leverages prudential regime. Possible additional EU/UK supervision requirements plus cooperation.

Proposed FTA approach for

1. Market access
2. Prudential regime
3. Supervisory cooperation

Bilateral agreement on the basis of regulatory alignment giving effect to:

- Mutual market access based on agreed prescribed requirements by UK-EU (minimum harmonisation regime) and approved by the home regulator (UK/EU) for whole EU/UK.
- Recognition of and agreed prudential regime (no local governance, risk, capital or reporting requirements).
- Agreed prudential supervisory cooperation and college framework.
- Conduct per local home regime.
- Ability for business to flow UK-EU/EU-UK implicit.

Relative merits of proposals

- This approach is preferred as it provides flexibility, focuses on outcomes and does not tie EU and UK into mirroring each other’s regimes.
- Provides mutual market access, prudential supervision, equivalence certainty.
- Allows transactions to flow freely UK-EU and vice versa.
- Local member states conduct regimes.

Meets criteria

Supports business models

Overall rating of FTA option:

- Longevity/certainty – no short-term risks
- Flexibility to adapt to regime changes
- Level playing field (Equivalence)
- UK-EU transaction flows (IDD Art 16)
- Market access (re)insurer (I) and broker (B)

H M L – effectiveness measure/score
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Please note that members have acted in an individual capacity in developing these proposals and this report should not be taken as representing the views of the firms and organisations that they work for:

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