Brexit for insurance
Inbound passporting considerations for UK branches of EEA-headquartered firms
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Insurance companies incorporated in countries other than the UK in the European Economic Area (EEA) play a significant role in the UK’s insurance market, using ‘passports’ – rights enshrined in the EU and EEA’s constitutional documents to establish UK branches (the Freedom of Establishment) or to sell directly into the UK from abroad (the Freedom to Provide Services).

These so-called inbound passports affect the UK market in three main ways:

► London is one of the hubs of the global insurance market, insuring and reinsuring both domestic and international risks on a massive scale. It is estimated that London branches of insurers headquartered elsewhere in the EEA but with a branch passport in the UK underwrite almost £6b of insurance premiums in the London market.¹

► Other EEA companies write insurance in the UK’s domestic market through passporting branches in this country. Some are household names with significant market share.

► Others write insurance directly into the UK from other EEA countries without a local presence, using services passports, and channels such as internet platforms and retailers selling ‘add-on’ insurance products. Our focus here, however, is on UK branches and the uncertainties that they face.

Unless continued access is negotiated, the ability to passport between the UK and other EEA states will be lost on Brexit. Insurance firms currently holding an inbound branch passport would therefore have to apply to the Prudential Regulation Authority (PRA) for authorisation in order to continue trading in the UK. Obtaining authorisation is a substantial process and we expect it would have to be largely completed before the outcome of Brexit negotiations is known.

Not only future trading is at risk. No one knows yet the regulatory status on the day after Brexit of business written in UK branches before Brexit. Obtaining UK authorisation before or immediately on Brexit will provide branches with certainty.

By providing early clarity to insurers and seeking to avoid cost and inefficiency in the authorisation process, UK authorities have the opportunity to minimise disruption in the UK’s domestic and international insurance markets due to Brexit, and develop the reputation of the UK and the London insurance Market as a business-friendly jurisdiction.

Inbound passporting considerations for UK branches of EEA-headquartered firms

The Solvency II framework includes provision for EEA Member States to authorise and supervise local insurance companies and branches of non-EEA insurance companies (‘third-country branches’), operating in their territory.

The UK was influential in the development of this framework, and we assume that the UK will continue the existing regime for companies and third-country branches, as set out in the Solvency II Directive, following Brexit.

The third-country branches regime currently applies to non-EEA (re)insurers with branches in the UK. It is written into UK law and covered by Solvency II for direct business (the PRA applies the same rules to reinsurance branches, by default), and will not be directly affected by Brexit, as third-country branches can only operate in the country of the branch. It is our working assumption that the current treatment of third-country branches will be applicable after Brexit to branches of insurers from the UK’s former EEA partners.

The register of insurance undertakings maintained by EIOPA currently identifies a total of 58 third-country insurance or reinsurance branch licences across the EEA, 41 of them in the UK. The PRA and its predecessors have tended to prefer non-EEA insurance groups to form a UK subsidiary, as this gives more local control (via UK directors), and indeed the regulators have strongly encouraged subsidiarisation of existing branches. Many of those still in existence have been in run-off. However, Brexit may well offer an opportunity to change the UK’s thinking on this issue, in the case of companies subject to a regulatory framework that the UK took a leading role in developing.
Options for EEA (re)insurers with current UK branch operations operating under passport

Brexit negotiations will determine whether UK branches of EEA insurers will be permitted to continue in business under some form of phased implementation or agreement between the EU and the UK. In order to provide certainty to customers, companies are developing contingency options in case no deal is made.

In this context, there are two main options available to an existing UK branch of an EEA insurance company:

► To seek authorisation as a third-country branch, effective from Brexit; or
► To convert to being an authorised UK subsidiary in advance of Brexit.

The third-country branch route seems to offer some advantages (for the reasons set out overleaf), either as the end state or as a way of delaying a decision to convert to a full subsidiary until a later time when conditions may be more favourable. With this route, the process can be simpler and some UK tax complications can be avoided.
Option 1

Convert an inbound branch to a third-country branch

This option does not require any change in legal entity, and is therefore potentially seamless as far as customers, personnel, suppliers and reinsurers are concerned. Tax complications are less likely, though could still arise if there are policy transfers from head office.

Maintenance of a third-country branch in the UK requires local substance and branch governance, and the branch will be required to meet Solvency Capital Requirements (SCR) and Minimum Capital Requirements (MCR) at branch level. However, the PRA has indicated that some requirements may be waived for pure reinsurance branches.

A procedural difficulty is that a passporting branch is not, pre-Brexit, from a third country. The existing process does not contemplate application from an EEA-authorised insurer and the ability of the PRA to entertain an application for a third country branch authorisation is therefore constrained. Access to this option depends upon the adoption by the UK authorities of a pragmatic approach to achieving the same substance as a formal application, with a view to provisional authorisation that would become effective immediately when Brexit occurs. It will also, in practice, require the co-operation of the company’s home state regulator.

The application process for establishing a third country branch in the UK is generally the same as it would be for setting up a new company, but the emphasis is on the proposed business and governance of the branch. Some branches may be required to enhance their substance in the UK, as the European Directive definition of a branch for Freedom of Establishment purposes would not necessarily require all that a third country branch would need in this respect.

When making a decision on a passporting branch or subsidiary, the PRA is likely to review the organisation, and any parent, as a whole.

It is conceivable that a company will need greater substance overall in order to meet the UK’s governance requirements at branch level, once the UK branch is reporting to the PRA.

Questions the PRA will consider might include:

► Who is the head office supervisor?
► What substance is there in the company’s head office and other branches?
► How big is the UK branch compared with the company?
► Does the UK branch run the company rather than the other way round?

If the UK authorities are in principle prepared to consider this option, continuing as a branch is likely to be the best ‘plan A’ for many EEA companies with an inbound branch passport in the UK. It also leaves open the possibility of transferring the business to a new subsidiary at a later date rather than at a time when the regulators and courts are likely to have many authorisation and transfer applications. A transfer from a UK branch post-Brexit would also be under UK rules rather than home state rules as would currently be the case.

Tax implications are minimal as the legal entity remains the same. In light of the likely increased substance within the UK branch the transfer pricing policy and branch profit allocation will need to be reviewed.

Any transfers of assets or intangibles from the head office to the UK branch should be VAT free. However, such movements could trigger a corporation tax cost by way of a taxable gain in the head office. There are various tax strategies available to mitigate such impacts.
This option involves the creation of a new PRA-authorised subsidiary from scratch, or the purchase of an existing authorised company, and either transferring the business from the existing branch or writing only new business in the subsidiary and leaving the branch to run off. Forming a subsidiary has recently been the preferred route for UK market entry from third countries as far as the PRA is concerned. It will probably remain so in cases where a third-country branch would be particularly material or additional credibility was required from the parent company.

Subsidiarisation has the advantage that the process is clear, and there is no barrier to the group seeking it or the PRA approving it, in advance of Brexit. In practice, the resources of both the regulators and, for transfers of business, the courts, are likely to be increasingly strained as Brexit approaches and more groups with inbound or outbound passports seek this route to preserve their access to markets that a ‘clean’ Brexit would deny them, before Brexit occurs.

### Typical authorisation application timeline

<table>
<thead>
<tr>
<th>Preparing for authorisation application</th>
<th>0–6 months</th>
<th>Company authorised and able to conduct business</th>
<th>6–12 months</th>
<th>12–18 months</th>
</tr>
</thead>
</table>

A transfer of existing branch business can be initiated during the authorisation process, to be finalised say six months after authorisation.

The law allows the regulator six months to process an application for authorisation, and 12 months if the application is not complete, and there is limited flexibility.

By default, Brexit occurs two years after the UK makes the formal notification of the intention to leave the EU, so companies have a strong incentive to complete their part of the process quickly, and to ensure that applications are as complete as possible on submission. The timetable is likely to be at the lower end of the illustrated range if a transfer of existing branch business is not required, such that the new company will only take over renewals and new business. However, that would leave the business of the UK branch to run off, potentially for many years. The regulatory status of a run-off branch after Brexit is not clear and closure may not be straightforward. Transfer of existing branch business before Brexit avoids that uncertainty, but at the cost of additional time pressure.

An authorised subsidiary is a new legal entity, so this option is not seamless as far as customers, personnel, suppliers and reinsurers are concerned. Contracts will need to be transferred or renegotiated, employees may need to be re-employed. The tax implications of this route will depend on the method of transfer. There are various strategies available to ensure that any corporate tax impacts are kept to a minimum so that taxable gains or losses are not triggered. From a VAT perspective we would expect to be able to VAT group both the UK branch and the authorised subsidiary. We would therefore not expect any VAT costs to arise on any transfers between the two. VAT grouping should also mitigate any VAT cost in respect of the authorised subsidiary providing services to the UK branch in run off. There is a significant potential capital cost of setting up a new subsidiary.

This option may be better seen as a ‘plan B’ for some companies with an inbound branch passport. For these however, it is imperative to determine as early as possible whether the authorities are prepared to contemplate option 1, because of the lead time involved in option 2.
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Business written via the Freedom to Provide Services (FoS)

This paper focuses on branches operating under branch passports, but some comments can also be made about companies currently operating in the UK under the FoS. One aspect of this is relevant also to branches, since some companies use their UK branches not only to write business in the UK but also to write business elsewhere in Europe using the company’s services passport.

Inbound business is written via Freedom of Services

Under a ‘clean’ Brexit, there would appear little scope for insurers with no UK establishment to continue writing into the UK from other EEA jurisdictions. UK residents can, in general, buy insurance from where they wish, but with few exceptions ‘non-admitted’ insurers cannot market it in the UK. The administration of existing policies also needs to be considered, as the regulatory status of this following Brexit is not clear.

Insurance companies that are affected could seek to preserve their market access by onshoring, establishing a UK branch or UK subsidiary, in the manner described above. However, the business model of many of these companies is unlikely to translate to an authorised branch or subsidiary platform. Such companies might consider the possibility of using the special status of Gibraltar, with its access to the UK insurance market, or the more limited access available to Channel Islands or Isle of Man insurers, to continue their business.

Inbound branch passport to the UK writing business in the EEA via FoS

Again, under a ‘clean’ Brexit, the ability to write into EEA countries on UK branch paper is doubtful for some countries at least (though there will be limited exceptions in some countries). This is due to uncertainty over whether insurance activity performed outside the EEA enjoys the protection of FoS.

UK subsidiaries will not enjoy passports either, and their ability to insure risks in other countries will depend on the attitudes of different EEA countries to the use of ‘non-admitted’ insurance by their residents or for locally sited risks. These risks and uncertainties could have a material impact on some London market inbounds – for example, those writing multinational policies.

One possible solution is to write instead on EEA head office or other branch paper, via Lloyd’s or a sister company. However if activities of a non-UK company are performed in the UK, care will be needed to avoid creating a regulatory or tax establishment for a company, and moving non-UK renewals to other branches or to a different entity could itself have tax consequences.
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Final thoughts

The third-country branch option should offer less disruption to the business and preserves the possibility of subsidiarisation at a later date. The process for redesignation of a passporting branch as a third-country branch is not currently clear. There are few third-country branches currently in operation.

More certainty on future regulatory requirements is required to avoid disruption to the UK market and to retain and grow the London Market as a material segment of the UK insurance industry. Firms cannot wait for the outcome of Brexit negotiations and need to take action to preserve their business based on worst-case assumptions.

We therefore expect the industry would welcome early confirmation from the UK authorities as to the preferred options and application considerations and likely approach to requests for branch authorisation and conversion that firms can act on with confidence.

Next steps

1. Talk through the options with your EY contact and agree on the approach you propose to take

2. Be prepared to raise the topic with the PRA and with your home state supervisor: focus on whether the UK authorities are willing to consider the third-party branch option

3. Consider how best to interact with policy makers in the UK, either directly or via your trade association
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EYG No. 01405-174GBL
EY-000024041-01.indd (UK) 04/17.
Artwork by Creative Services Group London.
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