A BREXIT ROADMAP FOR THE UK SPECIALTY COMMERCIAL INSURANCE SECTOR

THE LONDON MARKET GROUP

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 20% of the City of London's total income, employing 48,000 people and controlling over £60 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

THE IMPORTANCE OF THE LONDON INSURANCE MARKET TO THE UK ECONOMY

The London Insurance Market is the global centre of specialty insurance and reinsurance. Its unique qualities of concentrated capital, expertise and ability to provide global coverage ensure that London is relied upon as the best place capable of undertaking certain types of business. The Government must protect that status in the negotiations with the EU.

- ! Currently over ***£8 billion*** of premium is brought annually to the London Insurance Market by brokers on behalf of EU customers.
- ! 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 UK and EU post Brexit.
- ! The EEA is an important non-life insurance market. Excluding the UK, its total non-life gross written premium (GWP) in 2015 was ***US$432 billion***, 21% of worldwide non-life GWP**.**

If UK-domiciled insurers and reinsurers cannot carry on business in this large market on the UK's doorstep, the UK is a materially less attractive location for international insurers, reinsurers and investors.

This document sets out a roadmap for the Government as it begins its negotiations with the EU. It presents suggestions for how a new access arrangement could be approached, the benefits and reciprocal rights that could be given to EU partners and describes how the industry is currently planning for Brexit.

Understandably Brexit raises concerns among clients of the London Insurance Market about their future access to the Market's services. This is creating uncertainty in the minds of EU customers over the settlement of claims and the continuity of cover in future years and some are already seeking to reduce their exposure. Many of their policies will have a duration longer than the two-year Article 50 negotiating period for the UK to leave the EU. Others will give rise to claims that will be settled after this period.

LONDON INSURANCE MARKET BREXIT OBJECTIVES

OBJECTIVE

Regulatory equivalence under Solvency II: While this would not give market access rights to the EU for UK insurers and reinsurers, it is important in agreeing a trade deal with the EU that our prudential regulatory regimes remain comparable.

OBJECTIVE

A right for UK insurers and reinsurers to have unimpeded access to the EU market: A new trade agreement with the EU, which gives a specific right for UK-based insurers and reinsurers to accept business introduced to them by brokers from the EU and a reciprocal right for EU insurers and reinsurers to do business in the London Insurance Market, unimpeded by additional capital requirements and allowing home state prudential supervision.

OBJECTIVE

Early agreement of an implementation period with market access rights: It is important to agree at the start of the negotiations an implementation period to move to the new agreement, during which the industry's current market access rights would be retained. Uncertainty over whether insurance policies will be enforceable is already affecting the decisions of the London Insurance Market's clients.

OBJECTIVE

REGULATORY EQUIVALENCE UNDER SOLVENCY II

Equivalence under Solvency II does not give single market access rights and is not an alternative to the access arrangements the industry currently enjoys. Solvency II gives no access rights to non-EEA insurers, which is why a new trading agreement, as set out below, is essential. Equivalence to Solvency II would only mean that UK-based reinsurers - representing 40% of the London Insurance Market's EU business - would be treated in the same manner as reinsurers inside the EU by member states.

Solvency II helps to promote a number of the strengths of the London Insurance Market. These include a strong balance sheet; networks of international licences which facilitate access to markets and the ability to write global programmes including EU located risks; and an internationally well-regarded system of regulation that encourages transparency. Two of the UK's major competitors – Bermuda and Switzerland – are already Solvency II equivalent, and the US and EU have recently concluded an agreement that will promote the removal of regulatory barriers (see below).

Clearly the UK will have a regulatory regime that is exactly equivalent to Solvency II at the point that it leaves the EU. The UK will need to maintain an insurance regulatory system that is broadly equivalent to Solvency II to underpin a new agreement with the EU. We expect that the EU will not permit UK undertakings to carry on business in the EU if there is a fundamental divergence in regulatory standards.

UK reinsurers need clarity that the UK supervisory regime will be accorded full Solvency II reinsurance equivalence immediately on Brexit to prevent a period of uncertainty. The application process for seeking Solvency II equivalence can be lengthy. For example, Bermuda, Switzerland and Japan have each had to go through a five-year process.

The process of seeking regulatory equivalence should therefore be initiated by the UK as soon as possible so that the relevant formalities for granting such equivalence are complete by the time the UK leaves the EU. As part of the negotiations the UK should offer reciprocity to the equivalence ruling by permitting EU reinsurers to write UK business, under home state prudential supervision rules. This would provide a significant benefit to EU companies and may help to speed up the equivalence ruling.

OBJECTIVE

A RIGHT TO HAVE UNIMPEDED ACCESS TO THE EU MARKET

Over £8 billion of premium is brought annually to the London Insurance Market by brokers on behalf of EU customers. Currently, the use of passports is widespread across insurers, reinsurers and brokers in the London Insurance Market. Over 80% of non-Lloyd's London market insurers and reinsurers use passports (inbound and outbound) and 75% of London Insurance Market brokers use outbound passports, all on a freedom of establishment and/or service basis. This access gives London a significant competitive advantage and a unique ability to provide customers with both multi-territory policies and global wholesale insurance, all from the same location.

It is therefore essential that a new UK – EU trade agreement covers both insurance and reinsurance. This comprehensive agreement would have the benefit of removing uncertainty regarding future rulings on regulatory equivalence and would secure long-term unimpeded access to the EU market for UK insurers and reinsurers.

As a minimum, it must provide a specific right for UK-based insurers to accept business introduced to them by brokers from the EU market. This should be done on the basis of home state prudential supervision, with no obligation to meet additional capital requirements in the host state. This is imperative because regulatory equivalence does not give either UK or EU insurers the access they need. The new agreement must also ensure that brokers have the ability to transact cross-border business freely. The agreement should also contain reciprocal rights for EU-based insurers seeking to provide insurance into and in the UK, including London Insurance Market participants.

HOW SHOULD THE NEGOTIATIONS BE APPROACHED?

We welcome the reference to the UK being a global leader in complex insurance in the February 2017 Brexit White Paper and note the Government's position that it will "*prioritise seeking the freest and most frictionless trade possible*" with the EU; including the "*freest possible trade in financial services*".[1]

LMG members would like to see a trade agreement for the non-life insurance sector, as part of the UK's new strategic partnership with the EU. We encourage the Government to see the insurance sector as a priority to ensure that London maintains its position as the global hub for commercial non-life insurance.

As part of the negotiations, the UK could immediately offer access under the new agreement on a reciprocal basis to EU insurers and reinsurers, recognising home state prudential supervision of their branches based in London. This would send an important positive message to EU clients and investors that they would be able to continue to access the London Insurance Market, allowing them to retain and bring with them significant inward investment.

[1] HM Government, The United Kingdom's exit from and new partnership with the European Union, February 2017, page 42

EXISTING AGREEMENTS

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 Government should consider such agreements as it prepares for and undertakes the negotiations.

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 trade agreement.

Agreement	Measures to note	Issues the Agreement does not cover
US - EU Covered Agreement[2] In January 2017, US and EU authorities finalised a Covered Agreement to remove trading barriers.	**Removes capital requirements:** The removal of the need for discriminatory statutory collateral and local presence requirements for US and EU reinsurers operating in each other's markets. **Recognises home group supervision:** 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. **Regulatory cooperation:** 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.	The Agreement does not cover direct market access rights for insurers.
Bilateral Agreement between Switzerland and the EU for non-life insurance[3] Signed in 1989 and effective from 1993, this gives Swiss insurers specific freedom of establishment rights to operate in the EU and reciprocal rights to EU insurers.	**Reduces capital requirements:** It limits capital requirements to the possession of a minimum guarantee fund or a minimum solvency margin. **Home state supervision on capital:** 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. **Provides a mechanism to influence regulation and arbitration:** A joint committee composed of representatives from Switzerland and the EU to administer the Agreement, it also includes an arbitration process in the case of any disputes.	The cross-border offering of insurance to Europe from Switzerland is not permitted. A Swiss branch is still required in an EU country. Insurers must have personnel in the respective EU countries.

[2] Bilateral Agreement between the European Union and the United States of America on Prudential Measures Regarding Insurance and Reinsurance, 2017 (Covered Agreement)

[3] Agreement between the European Economic Community and the Swiss Confederation on direct insurance other than life assurance, 1993

OBJECTIVES FOR THE NEW UK - EU TRADE AGREEMENT

Consistent with the concept of a strategic partnership between the UK and EU and considering the potential precedents set by existing international agreements, a trade agreement on insurance and reinsurance should include:

- **Access and home state supervision:** Access could be agreed giving a specific right for UK-based insurers and reinsurers to continue to provide cross-border services to the EU and to retain their EU branches. Brokers should also be provided with the right to carry out cross border trades as is possible today. In return the UK should offer a reciprocal right for EU insurers and reinsurers to access the London and wider UK market. Both should be unimpeded by local authorisation, capital or collateral requirements. UK and EU insurers and reinsurers operating in the other market will only be subject to prudential oversight by the regulators in their home jurisdiction; but conduct oversight in the host jurisdiction.

- **No additional capital or collateral requirements:** There should be no obligations for UK insurers and EU insurers to meet additional local capital requirements. Given the measures within the Swiss and US bilateral agreements and that the UK is currently compliant with Solvency II, EU regulators could be reassured that UK-based capital would still be available to pay out claims in EEA countries and could therefore remain in the UK.

- **Regulator co-operation:** The insurance regulatory authorities in the UK and the EU should continue to exchange supervisory information on insurers and reinsurers that operate in both markets, facilitating supervision of insurance groups and home state supervision.

- **Maintaining UK influence:** The UK should seek the closest possible relationship with EIOPA, which has considerable influence in the development of new EU insurance regulations. It could write into the new trade agreement the establishment of a Regulatory Liaison Mechanism, to ensure that issues of mutual supervisory relevance can continue to be discussed. As set out above, a precedent is the Joint Committee responsible for administration and implementation of the Bilateral EU/Swiss Agreement.

- **Reciprocal recognition of EU insurers:** All of these rights outlined above should be offered to EU insurers currently operating in the UK to allow them to continue to write UK business. This would protect London's cluster as it will retain market participants who might otherwise choose to operate in an EU27 country absent continuing rights of access from the UK to the EU.

OBJECTIVE

AN IMPLEMENTATION PERIOD WITH MARKET ACCESS RIGHTS

A period of time that allows for the continuation of the London Insurance Market's existing market access rights and current supervisory arrangement is crucial.

This would give the London Insurance Market's clients the certainty they need to keep their business in London and 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 the implementation period and the retention of market access rights during this time until the new trade agreement comes into force could also remove the need for UK businesses to reorganise before they know the detail of the new relationship.

Clients choose the London Insurance Market because of its ability to offer specialty expertise and flexibility including long-term and global policies. This implementation period would help to prevent a significant potential outflow of business, capital and expertise from London.

The Government should clarify their expectations on timescales in respect of agreement for a phased implementation period as soon as possible. If the Government can give reassurance at the start of the Article 50 process that the UK insurance industry does not face a 'cliff edge' in two years' time, UK brokers and insurers can work on their contingency plans at a more measured pace. If the Government cannot give this reassurance, companies will implement their 'worst case scenario' plans from the beginning of the Article 50 process. Many firms will establish separate EU subsidiaries, pulling significant capital and expertise out of the London Insurance Market.

The benefits of an early agreement on an implementation period would be to:

- **MAINTAIN LONDON'S COMPETITIVE ADVANTAGE:** With continued access rights until a new agreement comes into force, UK insurers and reinsurers would then be able to renew insurance contracts covering EU risks in London. Without access, UK brokers and insurers will not be able to renew or write new business covering risks in EU countries unless they set up an establishment in the EU to write this business. The uncertainty provides a window of opportunity to the UK's competitors to take business away from London, and a number of EU member states are already actively marketing for insurers' relocation to the EU.

- **GIVE CERTAINTY TO EU INSURERS HEADQUARTERED IN THE UK:** Major EU insurers will need to decide whether to create separate UK companies to write UK business if post Brexit they are unable to passport in to write business. An implementation period which retains current access, would give EU insurers and their clients greater confidence about their future position in the UK, encourage them to maintain their talent in London and retain their business and investment in the London Insurance Market.

- **GIVE CERTAINTY TO CLIENTS THAT THEIR POLICIES WILL BE RENEWABLE IN LONDON:** Our clients will benefit from continued access to the specialty expertise of the London Insurance Market, and the ability of its insurers to offer long-term and global policies.

- **REMOVE THREAT OF EU TRADE BARRIERS:** Reinsurance currently makes up over 40% of London's business with EEA countries. Countries such as Germany have restrictive local laws on the provision of reinsurance from non-equivalent third countries. This includes 'non-solicitation' rules, which could prevent UK reinsurers and brokers proactively seeking business in these markets after we leave the EU. An implementation period would prevent these protectionist policies affecting the London Insurance Market.

DOMESTIC REFORMS

REGULATION

Regulation is a key factor for top level boards of directors in deciding where to place capital investment. With significant M&A activity within the sector over recent years, these decisions are often now made outside the UK. It is vital that regulation remains proportionate and does not put London at a disadvantage. This represents the best way to prevent significant capital flows from leaving London.

Many competitor jurisdictions are actively courting financial services in the UK and offering incentives to move their business abroad. For example targeted companies have been offered the opportunity to file in English, have their applications for licences and branches fast tracked as well as providing a more personalised service than that offered by the PRA.

After Brexit, regulation will be an even bigger factor for foreign investors in deciding where to place capital investment and it is vital that our regulatory regime helps the London Insurance Market to compete.

Our competitors in Singapore, Qatar, Dubai and Bermuda have regulators with statutory duties to actively support the promotion of their local insurance markets. The FCA and PRA do not have such objectives and are not required to have regard to the impact of their actions on the competitiveness of the financial services sector. LMG would like the Government to consider the following reforms:

- Giving the PRA and FCA a balancing statutory objective to consider the international competitiveness of the UK financial markets. This is something that is being consistently called for across the industry and would at the very least mean that they would have to consider the impact of their actions on the competitiveness of UK financial services.
- The creation of a dedicated inward investment unit in the PRA to support and encourage new entrants to the UK as well as retain those currently present through the implementation of the new agreement. This mirrors many of the practices of our international competitors such as Bermuda and would ensure that the PRA maintains a day-to-day focus on helping to maintain London as the global centre for specialty commercial insurance and reinsurance.

ACCESS TO TALENT

The unequalled pool of global talent and expertise assembled in the UK is a major competitive advantage for the commercial insurance industry. To retain its status as the leading global centre, the UK needs continued access to the best talent, a mixture of home-grown, from across the EU and from the rest of the world.

Future UK immigration policy should be designed to broaden the future pool of international talent that the industry can access. It must also facilitate intra-company transfers of staff between different locations around the world. In particular, EU nationals working in the London Insurance Market should be reassured that they will be able to continue to remain in the UK post Brexit, whilst new talent should not be deterred from coming to the UK by the uncertainty of their future status.

COMPANY DECISION MAKING AND CONTINGENCY PLANNING

During the Article 50 negotiations, London's customers, through their brokers, will be deciding where to renew their policies. LMG has evidence that in recent renewal discussions clients are opting to move business now.

Many clients require policies with terms of three years and longer, which means that they need certainty beyond March 2019. If there is no certainty about the UK's future trading relationship with the EU, many of these customers are likely to choose not to renew their policies in London or at the very least to reduce the proportion currently placed in the London Insurance Market. Their rationale for this is that moving their business elsewhere increases the certainty that it will be possible to pay out claims regardless of the outcome of the UK's negotiations.

This is driving the decision-making of the industry. Insurance brokers, UK insurers and EU insurers headquartered in London are now considering the future structure of their organisations and contingency plans that will need to be implemented before the UK Government can agree a new trade deal with the EU.

In the worst case scenario these contingency plans involve the creation of a separate subsidiary company in another EU member state. This would allow these companies - after we leave the EU in March 2019 - to continue to do business across the EU and give customers certainty about the future of their policies.

Consultation with LMG members has suggested that the typical transaction cost could be as much as £50 million and that capital costs could be even higher, due to the need to split into two entities and the loss of diversification.

A significant proportion of the London Insurance Market's premium is reliant on a small number of global brokers – 16 brokers control approximately 82% of London's premiums. Their global company structures give them the flexibility to transfer placement out of London without this impinging significantly on their business. If any one of them pulled out of London - due to the concerns of their clients - it would have serious and negative consequences for the London Insurance Market.

These decisions are likely to accelerate (unless there is clarity from the Government before then) when 2018 renewals take place – at this stage, policies will cover the period beyond March 2019 and there needs to be certainty about the regulatory regime under which the UK will be operating.

TIME LINE OF COMPANY DECISION MAKING

JANUARY – JUNE 2017

Companies are considering Brexit contingency plans.

JUNE 2017

Companies will need to begin to implement EU subsidiary plans – including applications for new authorisations and potential business transfer process. This is likely to be an 18 month - 2 year process.

JANUARY – MARCH 2018

The industry at this point would need further insight from the Government on the progress of negotiations and importantly whether an implementation period has been agreed.

Decisions will be need to be taken in moving ahead with more costly business transfer decisions, such as informing all policyholders regarding future company structures.

APRIL 2018

Contracts issued for a duration of 12 months will expire post Brexit. Clients will need clarity with their brokers on their UK insurers' future EU structure and certainty over claims payments.

SEPTEMBER 2018

2019 renewal strategies between insurers and brokers will be finalising and UK insurers must be able to show that they can write business in the EU.

DECEMBER 2018

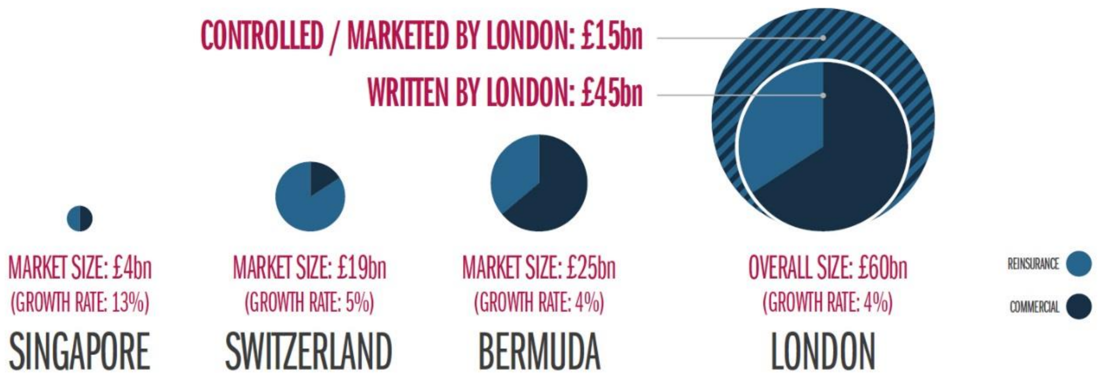
UK insurers will begin to use new EU structures in preparation for 2019 renewals.

JANUARY 2019

Key renewal date for 2019 policies and beyond.

THE LONDON INSURANCE MARKET'S CURRENT SIZE AND IMPORTANCE

THE LONDON INSURANCE MARKET IS CURRENTLY THE LARGEST GLOBAL HUB FOR SPECIALTY RISK, CONTROLLING MORE THAN £60BN IN GWP IN 2013



AS AN INDUSTRY IT INSURES ALL CONCEIVABLE TYPES OF RISK

THE MARKET IS A SUBSTANTIAL CONTRIBUTOR TO THE LONDON ECONOMY

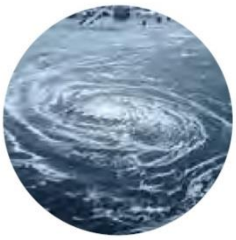
IT EMPLOYS 48,000 PEOPLE…

34,000 PROFESSIONALS IN LONDON

ANOTHER **14,000** WORK FOR LONDON MARKET COMPANIES IN THE UK, BUT OUTSIDE OF LONDON

… AND SUPPORTS THE BROADER GLOBAL ECONOMY BY PAYING LARGE CLAIMS EVERY YEAR

DEEPWATER HORIZON 2010
$600 MILLION



JAPANESE QUAKE & TSUNAMI 2011
$1.95 BILLION

NEW ZEALAND EARTHQUAKE 2011
$1.2 BILLION

AUSTRALIAN FLOODS 2011
$650 MILLION

MORE THAN £140 BILLION
CLAIMS PAID IN THE **LAST FIVE YEARS**

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