

PRA CONSULT ON APPROACH TO INSURANCE BRANCH AUTHORISATION AFTER BREXIT

On 20 December 2017, the Prudential Regulation Authority ("PRA") published a consultation on a draft supervisory statement "International insurers: the Prudential Regulation Authority's approach to branch authorisation and supervision" (CP30/17). In CP30/17 the PRA seeks views on its proposed approach to the authorisation and supervision of third-country insurers that carry on business in the UK through a branch or subsidiary. The consultation closes on 27 February 2018.

This note considers the impact of the PRA proposals on insurers many of whom, as part of their contingency planning following the 23 June 2016 referendum vote for the UK to exit the EU ("Brexit"), may have existing or prospective insurance firms within their groups which are carrying out insurance business in the UK using either a services or establishment passport, and which will no longer be able to use these passporting rights post-Brexit (subject to any agreement reached between the UK and EU on single market access for financial services).

RESPONSE TO PROPOSALS

In general, the PRA's proactive engagement on its supervisory approach following Brexit will be welcomed by firms. However, there are a number of areas where clarification and possible revision of the proposed approach may be desirable. These areas and our suggestions for a revised approach are outlined below:

Treatment of current branches

- The PRA proposes that current EEA passported branches will have to apply for authorisation in order to undertake PRA regulated activities in the UK after Brexit. In particular, the PRA suggests that application for authorisations of these EEA branches will "then be treated in the same way as other insurance branches". We suggest that the PRA reconsider this proposal as it ignores the principle of mutual recognition on which the passporting regime is based and which forms the basis on which the branches are currently operating in the UK.
- In reconsidering this proposal, we suggest the PRA could implement a 'grandfathering' process for existing EEA branches with a simplified application process. This process would take into account the fact that the current operations of EEA branches are in compliance with the regulatory requirements of the home state and so should not, for example, require submission of a new business plan. We would hope that this grandfathering process could be completed with a 3 to 6 month period (and not the 12 month period proposed) in order that it can operate alongside

Key proposals

- When considering a branch application, the PRA will take into account the scale of branch activity covered by the Financial Services Compensation Scheme ("FSCS") and the impact of any possible failure of the firm on the financial system and insurance market.
- The PRA proposes that firms which are likely to have more than a £200 million of FSCS-protected liabilities should conduct business in the UK through a UK subsidiary rather than a branch.

the UK-EU negotiations and be responsive to the final decisions on transitional and/or future trading arrangements.

FSCS protected liabilities

- The PRA proposes that firms which are likely to have more than £200 million of FSCS-protected liabilities should conduct business through a UK authorised subsidiary rather than conducting business here through a branch.
- The term 'FSCS-protected liabilities' is not defined in CP30/17, nor is it defined in the PRA Rulebook or FCA Handbook. It is therefore not clear what the PRA means by the term in the context of CP30/17. For this reason, greater clarity is needed on its meaning as well as technical certainty about how attainment of the threshold is calculated.
- Although not stated in CP30/17, we believe that the PRA intend 'FSCS-protected liabilities' to mean an estimate of the aggregate amount of protected claims of eligible claimants, calculated gross of reinsurance. This could result in the £200 million figure being easily exceeded by many insurers who currently have EEA branches or who are considering a new UK branch. If instead 'FSCS-protected liabilities' were to be calculated net of reinsurance, this would ensure that the £200 million figure is a realistic assessment of the risks actually borne by such firms and will mean that the figure is less likely to be exceeded by a substantial number of branch applicants.
- Alternative approaches to defining a threshold that might hinge on a narrow set of liabilities, for example, one focused on those which are directly 'retail' (and so might exclude some insurance liabilities protected by the FSCS such as compulsory insurance taken out by commercial firms) or one which would define a threshold subject to the exclusion of large compulsory insurance reserves, such as employers' liability.

Run-off insurers

- CP30/17 does not consider the impact of run-off of liabilities. The £200 million threshold may not be appropriate where the relevant business is in run-off and the liabilities may decline.

Third-country branch criteria

- In CP30/17 the PRA proposes high-level criteria that it will consider when making its assessment of an application from a firm for authorisation as a third-country branch. Some of the wording proposed in the criteria is too vague to allow firms sufficient understanding with certainty how the PRA's expectations may be met. For example, the PRA may reconsider their proposals to ensure that there is "sufficient supervisory cooperation" when dealing with EEA Regulators.
- The CP also refers to "appropriate priority in insolvency" and "no discrimination" as being criteria without further explanation as to the standard needing to be met. Since the Solvency II Directive provides a harmonised order of priority of insurance claims and treatment for creditors and does not discriminate between EEA and non-EEA policyholders in the case of an insolvency of an EEA insurer, the PRA should, in our view, deem the standard to be met for current EEA branches and new branch applications from EEA countries.

Background

- The publication of CP30/17 on 20 December 2017 followed two significant announcements from the PRA and the government made on the same day.
- The first announcement came in the form of [an open letter from Sam Woods](#), the Deputy Governor of the PRA, which sets out the regulator's post-Brexit approach to EEA firms currently exercising passporting rights to establish a branch or provide services into the UK ("inbound firms") and which is consulted on in CP30/17.
- The letter states that inbound firms will need to seek PRA authorisation to carry on PRA-regulated activities in the UK. In the meantime, and given the statutory deadlines that apply, the authorisation process may take up to 12 months from the point of application.
- Therefore, the PRA requests that impacted firms to submit applications for authorisation from January 2018. The PRA will review this timeline as the Brexit political process moves forward.

Financial stability

- The PRA proposes additional factors (such as the insurer's market share in a niche market and the level of connectivity to other stakeholders within the industry) to assess a third-country branch's potential impact against its objectives and risk to financial stability. The PRA believes that no third-country branch currently operating in the UK would, as a result of the above factors, be deemed sufficiently significant to the wider insurance market and financial system for it to be required to subsidiarise. Although this may be the case now, it is not known how the UK insurance market will change post-Brexit. For these reasons, stability of the system should continue to be considered by the PRA as it is currently for third country branch applications.
- However, there are aspects of the PRA's criteria that cause concern and for this reason we suggest the PRA reconsider the breakdown of the financial stability criteria in the way proposed. For example, the PRA suggest that an insurer may be considered "systemic" if they have a large share in a niche market or if substitute products are not available for the market. Such an assumption, in our view, should not require a subsidiary application as is suggested in the consultation.
- In respect of retail business, the PRA generally has a lower tolerance for failures in annuity and long-term business than in some non-life or reinsurance products. This suggests that the PRA perceives life business as intrinsically riskier than general and so may be more inclined to require a subsidiary application. The PRA should not generalise in this way and instead should consider any systemic risks posed by each insurer on a case by case basis and, ultimately, should acknowledge that, in general, firms carrying out traditional insurance activities do not pose the same systemic risks as banks.

How we can help...

Clifford Chance has a dedicated Brexit team monitoring political developments closely and this team works closely with our leading insurance practice to help identify the specific Brexit risks for your insurance or reinsurance business.

We are happy to assist you in determining the impact of CP30/17 on your business and can also help in preparing a response to the consultation.

Background continued...

- The second announcement on 20 December 2017 was made by Philip Hammond (the Chancellor of the Exchequer) who issued a [written statement](#) confirming that, as requested by the Bank of England and the FCA, the government will bring forward legislation which will enable EEA firms (including insurers) operating in the UK to obtain a "temporary permission" to continue their activities in the UK for a limited period after withdrawal and will legislate, if necessary, to ensure that contractual obligations, such as insurance contracts, which are not covered by the regime, can continue to be met.
- No further details are provided in the statement neither about the "temporary permission" regime nor on the legislation which will permit continuation of insurance contracts.
- There is nothing in CP30/17 that suggests that the PRA proposals are temporary in nature (although there are caveats to say the PRA proposals may change depending on the outcome of the negotiations between the UK and the EU) but we would expect that the PRA will inform firms of any proposed legislation and its impact.

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