BREXIT AND INSURANCE: LUXEMBOURG INSURANCE REGULATOR ANALYSES IMPLICATIONS FOR UNIT-LINKED LIFE INSURANCE PRODUCT INVESTMENTS

The Luxembourg insurance sector regulator Commissariat aux Assurances (CAA) issued this April an information notice exploring the implications of a possible no-deal Brexit in relation to investments of Luxembourg life insurance companies into issuers located in the UK or its dependent territories. This client briefing provides an overview of the impact analysis the CAA sets out in its notice and the action points and structuring considerations resulting therefrom for insurance companies and their clients.

Key issues

- No-deal Brexit impact on investment rules and restrictions of ULLIPs of Luxembourg insurance companies
- Re-classification of the UK as a zone A country (OECD outside EEA) and impact for investments
- Re-classification of the UK dependent territories as non-zone A countries and impact for investments
- Distinctions to be made between direct investments into external funds and indirect investments via collective, dedicated or specialised internal funds
- Action points for insurance undertakings in relation to existing and new ULLIPs structures as well as client and CAA communications

The CAA has issued information notice 20/11 regarding the implications of Brexit on the application of CAA circular letter 15/3 on 2 April 2020. This circular letter deals with the investment rules for unit-linked life insurance products (ULLIPs) offered by Luxembourg life insurance companies.

The notice explores the consequences of a Brexit without a deal on financial services as of the end of the transition period under the UK/EU agreement on the withdrawal of the UK from the EU on 1 January 2021 (No-deal Brexit) on the different types of ULLIPs, which offer exposure to external or internal funds (collective, dedicated or specialised funds).

1. Investments into external funds domiciled in the UK or its dependent territories

Regarding investments in external funds domiciled in the UK, ULLIPs offering exposure directly to external investment funds located in the UK will be treated, starting from 1 January 2021, as investments made in external funds located in a zone A jurisdiction (OECD non-EEA countries). Consequently, their use for a ULIP will as of that date be limited to 25% (of the total value of each contract) for UCITS or for open-ended alternative funds of funds and to 0% for all other types of funds. The exemption allowing for the application of the investment limits prescribed by the national law of the policyholder (even if resident in the UK) will only apply to open-ended real estate funds (for other funds, the exemption under circular letter 15/3 only concerns policyholders situated in the EEA).

Regarding investment in external funds domiciled in UK dependent territories, these will after a no-deal Brexit no longer be eligible as ULLIP external fund investments.

These limitations that would be triggered by a No-deal Brexit will apply in respect of new insurance contracts concluded as of 1 January 2021 but will not automatically affect insurance contracts concluded before that date.

However, insurance undertakings need to communicate the impact of a no-deal Brexit on the investment restrictions application to policyholders as a new important risk element. The communication should be accompanied by a proposal of one or more investment alternatives in EEA external funds with similar investment strategies. The CAA deems it appropriate that the insurance undertaking also proposes the application of revised investment rules to the contract, taking account of the status of the UK and its dependent territories after a No-deal Brexit. Absent of a response or in case of refusal by the policyholder, the existing investment rules would however continue to apply to the relevant insurance contract and the insurance company would have to invest in accordance therewith.

2. Investments by internal funds into issuers domiciled in the UK or its dependent territories

Regarding internal funds of a Luxembourg life insurance undertaking, a distinction needs to be made between the three different types of internal funds that may exist:

a) Collective Internal Funds

After a No-deal Brexit, issuers located in the UK will be treated as issuers from a zone A jurisdiction (EEA, certain OECD countries and countries with similar prudential supervision rules) for the purpose of investment by a collective internal fund. However, issuers located in a dependent territory of the UK will then be treated as issuers from a non-zone-A country, in accordance with the categorisation under the CAA circular letter 15/3.

Collective internal funds created as of 1 January 2021 will be required to take account of the new classification of the UK and its dependent territories for their investments in issuers of these countries and territories.

Collective internal funds created before 31 January 2020 may continue to be managed according to the classification prior to a No-deal Brexit but may in such case only be used as support for insurance contracts concluded before that date. In case such an collective internal fund shall be used as support also for contracts issued after that date, its investment policy would have to be adapted in advance, in accordance with the rules set out in the CAA circular letter 16/3 and as further detailed in the CAA notice.

b) Dedicated or Specialised Internal Funds

As for investments by collective internal funds, issuers located in the UK will after a No-deal Brexit also for dedicated or specialised internal funds be treated as issuers from a zone A jurisdiction for the purpose of investments by those funds and issuers located in a dependent territory of the UK will be treated as issuers from a non-zone-A country.

Dedicated or specialised internal funds created as of 1 January 2021 will be required to take account of the new classification of the UK and its dependent territories for their investments in issuers of these countries and territories. This applies independently from the question whether the dedicated fund is created for a contract concluded before or after 1 January 2021.

In practice, the new status of the UK will have an incidence only for dedicated fonds of type A or B, given that type C and D funds may invest without limitation in all asset classes listed in Annex 1 of CAA circular letter 15/3.

However, shares/units of alternative funds issued by issuers established in UK dependent territories can no longer after a No-deal Brexit be considered as being included in Annex 1 and are hence no longer available to clients investing in C type dedicated funds. Only D type dedicated fund may continue to invest in such alternative fund shares/units.

Dedicated funds created before 31 December 2020 may continue to be managed according to the classification prior to a No-deal Brexit, except in case of an instruction to the contrary by the insurance company's client.

The CAA finally considers that the new classification of financial instruments issued by issuers domiciled in the UK and its dependent territories for new dedicated funds constitutes for the holders of contracts invested in existing dedicated funds an important element for the appreciation of investment risks and needs to be brought to their (and as the case may be their investment manager's) attention. It is then up to the policyholder and its investment advisor to appreciate the opportunity to modify or not the investment policy.

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