Fountain Court CHAMBERS

THE ROAD AHEAD FOR UK INSURERS AND REINSURERS: RETHINKING EQUIVALENCE

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Summary

This article considers the position of UK insurers and reinsurers following the conclusion of the Trade and Cooperation Agreement.

In light of the brief treatment given to financial services in the Agreement, the industry's hopes have largely been pinned on EU equivalence determinations. However, it is crucial to bear in mind that equivalence means different things for different sectors. For the insurance sector, it is suggested that the EU equivalence framework does not provide an appropriate basis for the future relationship between UK and EU-27 insurers and reinsurers. In particular, the equivalence determinations provided by Articles 172, 227 and 260 of the Solvency II Directive do not replicate access to the EU insurance market that passporting previously offered.

It remains likely that, in the absence of any further negotiations or agreements, UK insurers and reinsurers will have to make their own arrangements to address market access and contract continuity.

On 24 December 2020, the EU and UK announced the conclusion of a Trade and Cooperation Agreement (2020) *Official Journal L444, p.14-1462* (the **TCA**). While it runs over 1,200 pages, the document says little about the continued operation of financial services (including insurance and reinsurance) in the UK. Instead, the parties published a separate Joint Declaration on Financial Services Regulatory Cooperation alongside the TCA. This records that, by March 2021, both parties will discuss and agree "how to move forward on both sides with equivalence determinations".

In this article, we examine what a potential equivalence determination could mean for insurers and reinsurers in the UK, and (if granted) what gaps would still remain in terms of market access.

What the TCA does (and does not) cover

In broad terms, section 5 of the TCA provides that UK financial services providers will retain the right to establish enterprises in the EU, subject to a "prudential carve-out"; namely, that nothing in the TCA prevents parties from adopting or maintaining measures for prudential reasons (Article SERVIN.5.39). The practical effect of the carve-out is that Member States can require UK providers to be established in and/or authorised in their jurisdictions and can use this as grounds for justifying other restrictive regulatory or licensing conditions. Notably (and perhaps predictably) absent from the TCA is any provision for continued 'passporting' rights.

In these circumstances, UK financial service providers have largely pinned their hopes on potential equivalence determinations as a means to secure continued market access in the EU-27. The European Commission's assessment of the UK's equivalence is ongoing and, at time of writing, it has made two time limited equivalence determinations for derivatives clearing and settling securities. It is worth noting as well that equivalence assessments can only be conducted and granted where a relevant EU instrument permits such a decision to be taken. These decisions are discretionary (as are decisions to withdraw equivalence), and it is unsurprising that they are highly politicised and drawn-out.

Equivalence for Insurers and Reinsurers

The relevant regime for the insurance market is codified in the Solvency II Directive (Directive 2009/138/EC), which sets out three distinct areas for equivalence:

1) Reinsurance (Article 172): Where a third country has been deemed equivalent, reinsurance contracts entered into with reinsurers in that third country are treated in the same manner as contracts entered into with EU reinsurers.
2) Group solvency (Article 227): Where EU groups have subsidiaries in equivalent third countries, those subsidiaries can follow local capital requirements instead of Solvency II.
3) Group supervision (Article 260): Where equivalent third country firms have activities in the EU, the EU supervisors can rely on the group supervision conducted by the equivalent third country regulator.

The critical implication of Solvency II is that equivalence does not protect the right of market access for UK direct insurers or insurance intermediaries. For those entities, equivalence under Solvency II is not a satisfactory substitute for passporting rights. As such, and absent a change in law at the EU level to provide for such equivalence decisions (which is highly unlikely), the position remains problematic for direct insurers and insurance intermediaries.

The position of UK reinsurers is considerably more optimistic, assuming the UK is eventually granted equivalence under Solvency II. However, such a determination comes with its

own set of problems. As described above, the assessment process is discretionary and may be politicised. Even if equivalence is granted, this can be withdrawn at the discretion of the European Commission (e.g. the withdrawal of Switzerland's equivalence following its disagreement with the EU in 2019). The equivalence of UK reinsurers under Solvency II could be taken away if the UK's regulatory system diverges from that of the EU-27.

Furthermore, equivalence under Solvency II is not a singular determination. It is assessed individually and discretely under Articles 172, 227 and 260. The European Commission previously decided that Australia, Bermuda, Brazil, Canada, Mexico and the USA are Solvency II equivalent, for group solvency purposes only (under Article 227), whereas, in the case of Switzerland, it was deemed Solvency II equivalent across all three areas.

The future

In short, equivalence is by no means a panacea for the problems caused by UK insurers' lack of passporting rights. There are well-documented steps which UK insurers themselves can take to mitigate that (for example, by establishing an EU subsidiary and/or acquiring an existing EU company). This is, of course, easier said than done. Some observers have suggested relying on the EU and the UK's membership in the WTO and the General Agreement on Trade in Services (**GATS**).

However, while Article II GATS does subject the EU / UK to the Most Favoured Nation principle, this is subject to a similar "prudential carve-out". It will do little to ensure a standardised approach to access.

As things stand, there are significant gaps for UK insurers and reinsurers in the wake of Brexit. It is hoped that this position will change with time.

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