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Brexit : Where does the journey go? - (1/3)

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This article is the first of a series of 3 articles which aims to focus on the consequences of Brexit on the marketing of life insurance policies under the freedom to provide services in the United Kingdom.

It will explore the various possible scheme options in the current situation.

What happened so far ?

Since 2016, when it had voted to leave the EU, the UK took that decision and officially left it's nearest and biggest trading partner on 31st January 2020. But not without a transitional period of a little less than another year to provide the UK and the EU with time to negotiate the details of the future relationship, but also, on the other hand, to consider a "Hard Brexit", hence an exit without any trade agreement.

However, during that period, "business as usual" was the order of the day:

EEA firms that had been operating through a passport in the UK under the existing European framework, were still permitted to continue their activities until 31st December 2020. In that respect, while mentioning "EEA firms" or "EEA providers", the present article is mainly referring to such (life) insurance companies.

As their passporting rights have been ceased due to expiration of the transition period, EEA firms need to obtain (new) UK authorisation in order to continue carrying out business as of 1st January 2021.

THE ONGOING SCENARIO – What are the options ?

1. The temporary permissions regime ("TPR")

One option to continue carrying out regulated activities in the UK was to apply for relevant particular permission ("Part 4A permission") under the so called Temporary Permissions Regime ("TPR").

UK legislation had delivered the TPR in order to allow firms that wish to continue in the longer term to operate in the UK for a limited period after withdrawal. Firms under the TPR will be deemed to have Part 4A permission for a maximum of 3 years.

That deemed Part 4A permission under TPR will be limited to what the firm held prior to exit day; hence, it is aimed to allow EEA firms that have owned UK marketing authorisation to continue new and regulated business within the scope of their former permission for a limited period of time (3 years), while seeking full authorisation of the Financial Conduct Authority ("FCA").

However, due to the fact that an EEA firm under TPR/ deemed Part 4A permission will be submitted to the full scope of the FCA supervision and rules, its home state restrictions on regulatory action will no longer apply.

- It will rather need to comply with additional rules:
  - a) FCA Principles of Business (in particular Principle 11 (notification to FCA), but except Principle 4 (financial prudence), since FCA will limit its supervision to UK business);
  - b) Financial Services Compensation Scheme (FSCS);
  - c) Financial Ombudsman Service;
  - d) Senior Manager and Certifications Regime ("SMCR") and Approved Persons Regime ("APR");
  - e) Safeguarding of clients' money and custody of assets through substituted compliance;
  - f) Compulsory Jurisdiction of FOS and complaints-handling rules;
  - g) Single Financial Guidance Body and Devolved Authorities ("SFGB") costs, from 2019/20 levy year onwards;
  - h) Illegal money lending ("IML") levy (applies to consumer credit TP firms).
- It will be subject to portfolio analysis.
- It will have to pay periodic fees to the FCA.

The UK regulator may also decide to apply further reporting or other requirements that would not be able to apply under the EU passporting regime.

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The FCA is still considering introducing some transitional relief in relation to certain aspects of following third country requirements imposed by UK law, namely:

- Branch Solvency and Minimum Capital Requirements for insurance branches;
- Prudential Regulation Authority ("PRA") remuneration rules where they go beyond minimum CRD IV requirements;
- certain reporting obligations where they involve the segregation of branch data and the reporting and review of this data where this is not already required;
- certain composite rules for insurance branches.

2. Financial Services Contracts Regime ("FSCR")

As a second option, amongst the TPR, UK government had published legislation (e.g. Financial Services Contracts (Transitional and Saving Provision) (EU Exit) Regulations 2019 or FSC SI) to enable firms that do not enter the TPR to orderly wind down their UK business under so called Financial Services Contracts Regime ("FSCR").

Unlike the TPR, the FSCR does not allow EEA firms to undertake new business in the UK after the exit day. The Financial Services Contracts delivers on the commitment of the Government to provide transitional relief in respect of "contractual continuity" issues associated with the loss of passporting rights by EEA firms at the point of Brexit. This is the risk that, as EEA firms lose their passporting rights, performance of their contracts becomes unlawful, resulting in significant market disruption.

The FSCR supplements and amends the EEA Passport Rights (Amendments, and Transitional Provisions) (EU Exit) Regulations 2018 (the TPR).

It also modifies certain aspects of the application of the Financial Services and Markets Act 2000 (FSMA) to firms that benefit from the transitional relief it provides, and amends the Solvency 2 Regulations 2015 in relation to certain insurance related activities.

a. The Contractual Run-Off ("CRO")

In that scope, the Contractual Run-Off ("CRO") is intended for EEA firms operating in the UK under the freedom of services regime, that have not entered the TPR but pre-existing contracts in the UK, which would require UK authorisation in order to maintain client services.

Firms entering the CRO may not have an existing relationship with UK regulators because they will have been providing services in the UK via a passport but without establishing a presence in the UK. Under the CRO they remain supervised by their home state regulators, as is currently the case. EEA providers are not able to enter into new contracts with UK customers but only allowed to carry out the regulated activities which are required to service and wind down their pre-existing contracts.

This regime allows EEA firms to continue to service its UK clients for a limited period (15 years), after which they are expected to wind down their UK business.

b. The Supervised Run-Off ("SRO")

The Supervised Run-Off ("SRO") under FSCR is intended for EEA firms with UK branches or top-up permissions in the UK, and firms who entered the TPR but who did not ultimately secure UK authorisation.

The SRO works much in the same way as the TPR. Firms operating under the SRO are within the UK regulatory perimeter and deemed authorised under the Payment Services Regulations and Electronic Money Regulations (PSRs and EMRs) for the purposes of winding down their UK regulated activities in an orderly manner. They are regulated and supervised by the FCA similarly to UK authorised firms, but they are only allowed to carry out the regulated activities, which are required to service and wind down their pre-existing contracts. In addition, unlike the TPR no notification is required to profit from the SRO, the regime applies automatically to firms falling on the above mentioned categories.

3. Policyholders' FSMA protection

TPR insurers are "relevant persons" for purposes of the Policyholder Protection Part of the PRA Rulebook and therefore required to pay FSCS levies in respect of new and existing policies that are protected by the FSCS. No transitional relief is available.

Policies issued prior to exit day that were FSCS protected policies continue to be protected for as long as the TPR insurer remains a "relevant person" under FSMA. If an insurer is no longer a "relevant person" under FSMA through the available authorisation mechanisms, policyholders will lose FSCS protection for acts or omissions (insured events) that occur after the loss of that status.

Policies that are issued or re-issued after exit day through a UK establishment of a TPR firm must relate to a risk or commitment situated in the UK, Channel Islands, Isle of Man or Gibraltar in order to be protected. New policies relating to EEA risks will not be protected.

For policies issued or re-issued after exit day through an EEA establishment of a TPR firm, only UK risks are FSCS protected (new policies relating to EEA, Channel Island, Isle of Man or Gibraltar risks will not be protected). Policies issued through an EEA establishment are only eligible for FSCS protection where the firm does not yet have a UK establishment (e.g. where a TPR insurer in the process of setting up a UK establishment issues policies through an EEA establishment after exit day).

This means that if a TPR insurer already has an establishment in the UK when it is in the TPR (e.g. it enters the TPR in respect of both freedom of services and a freedom of establishment business), FSCS protection will be available for policies that the TPR insurer issues after exit day from the UK establishment. Any policies that the TPR insurer has issued through the EEA establishment after exit day is not eligible for FSCS protection.

The next article will detail what happens when carrying business under the Freedom to Provide Services.

Acronyms lexicon:

APR: Approved Persons Regime

CRO: The contractual Run-Off

EEA: European Economic Area

FCA: Financial Conduct Authority

FSCR: Financial Services Contracts Regime

FSCS: Financial Services Compensation Scheme

SFGB: Single Financial Guidance Body and Devolved Authorities

SMCR: Senior Manager and Certifications Regime

SRO: supervised run-off

TPR: Temporary Permissions Regime

PRA: Prudential Regulation Authority

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