MARSH

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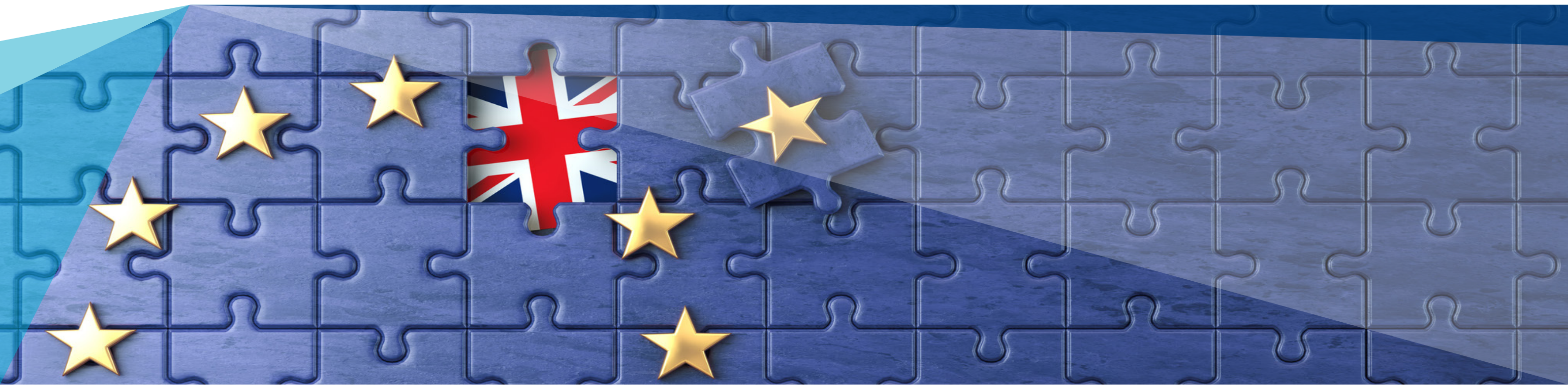
PREPARING FOR BREXIT: AN EU PERSPECTIVE



The United Kingdom (UK) will officially leave the European Union (EU) in under a year's time. However, the impact of 'Brexit' on Marsh's clients and insurance markets more broadly is still unclear, given the lack of clarity over what kind of trade agreement the two sides will ultimately reach following the UK's exit.

Transitional arrangements, to apply until the end of 2020 (during which time UK companies will continue to have access to the single market, and EU laws and directives will continue to apply in the UK), are under discussion but by no means guaranteed.

If a formal withdrawal agreement is not ratified prior to March 29, 2019 (or prior to the end of 2020, if there is a transition period), then trade in goods and services between the UK and EU will default to WTO terms – the 'hard Brexit' scenario. This would have far-reaching consequences. For goods, there would be an increase in frictional costs due to the introduction of tariffs; for services, non-tariff barriers such as loss of passporting for financial services firms will inevitably reduce cross-border activity in certain sectors.

There has been a good deal of speculation regarding what failure to reach a withdrawal agreement would mean for the UK, but the EU also has reasons to make contingency plans.

COSTS TO CONSIDER

The EU27 – the name given to the 27 countries which will form the EU following the UK's exit – is a net exporter to the UK. The cost to them will actually be higher on an absolute basis, estimated at approximately €35 billion compared to €31 billion for the UK, but proportionally lower when looking at the Gross Value Added (GVA), which is a measure of the value of goods and services produced in an area, industry or sector of an economy.

The EU is well positioned to mitigate the consequences. With a larger proportion of exports being goods rather than services, it has a wide range of alternative suppliers to choose from within the 27 remaining countries.

A CUSTOMS UNION WOULD BENEFIT BOTH SIDES

While the UK government's official position is committed to leaving the European customs union, remaining within the union or agreeing a new one which broadly maintains the same conditions would ensure costs arising from tariffs would be avoided and some border costs would also be reduced.

However, these benefits largely concern firms trading in goods and not those providing services – something not covered by a customs union – so such an agreement would not mitigate any impact on the financial services sector.

PASSPORTING

Passporting is the exercise of the right for a firm registered in the European Economic Area (EEA) to do business in any other EEA state without needing further authorisation in each country. Currently, UK insurers are able to insure risks anywhere in the EEA while being domiciled in the UK.

From an insurance market perspective, a key risk is the possibility that a breakdown in negotiations results in a 'hard Brexit', resulting in the loss of all passporting rights for UK-based insurers or brokers.

Any UK insurers who currently issue policies covering EU27 risks would need to obtain authorisation to operate in the EEA in order to continue to underwrite EU risks. This could be achieved by setting up new EU subsidiaries, transferring their registrations from the UK to an EU member state, or putting in place fronting arrangements or other partnerships with EU insurers (see below). As each insurer will need to solve for Brexit individually, the net result could be a reduction in choice for EEA insurance buyers. And time is against insurers to make all this happen by 'Brexit day'.

HISTORIC EEA LIABILITIES

A number of UK insurers are preparing to transfer EEA risk to EEA-domiciled affiliates or subsidiaries in order to be able to pay claims to an EEA insured if they lose their passporting rights. 'EEA risk' includes the EEA exposures covered by live policies, and any expired policies where a claim could still be notified and/or a claim settlement could still be paid against a loss in the EEA.

These transfers, known as Part 7 Transfers, are designed to protect the interests of EEA policyholders who have been insured by UK insurers in the past.

Any transfer of insurance business (such as this) is subject to a strict legal process, in which the insurer must seek court approval for the transfer, and policyholders have the right to make representations to UK regulators and/or the court if they believe that they will be adversely affected by the transfer.

The Part 7 process foresees that policyholders will receive (or be directed to) a Policyholder Statement, usually containing: a short letter introducing the transfer; a brochure summarising the scheme documents; an independent expert's report; and a notice of the date of final court hearing. Policyholders may raise objections with the insurer or with the court before the final court hearing approving the scheme.

OPPORTUNITIES AND THREATS

To a certain extent, the EU27 is in a position to benefit from the change in passporting rights. UK-based insurers may choose to partner with other insurers that already have an EU licence, rather than securing their own. Alternatively, some insurers may consider a fronting option. In this scenario, a fronting insurer with the requisite EU licence would be selected, ensuring continued access to EU passporting rights.

Lacking supply chains in the traditional sense and hence unable to fully mitigate direct costs resulting from Brexit, UK insurers that want to continue to write EEA business are likely to establish local sales, risk management and control functions inside the EU27. Over 30 insurers, including Lloyd's of London, have already announced plans to establish EU subsidiaries to mitigate the impacts of a hard Brexit.

MARSH AND BREXIT

Brexit presents a number of operational challenges for firms of all sizes across the EU. While a great deal of contingency planning is undoubtedly necessary, the uncertainty regarding final Brexit terms means that it will involve a number of hypotheses.

Post-Brexit, Marsh can effectively achieve passporting through its EU presence, existing licences, and breadth of experience. Marsh has offices in almost all EU countries, giving it the ability to provide wholesale insurance programmes.

As Brexit negotiations continue, readiness is critical and Marsh's dynamic approach can support organisations by:

- Reviewing participating insurers on programmes to assess their ability to maintain passporting, post-Brexit.
- Examining UK vs EU exposures and how differentiated organisational data can be captured and presented.
- Identifying what local advice may be required in EU countries and considering any alterations to current Marsh and insurer servicing model.
- Considering the most appropriate programme structure for a post-Brexit environment; this should be in place for upcoming renewals.
- Preparing contingencies for how programmes that straddle the Brexit date might be structured in the absence of any legislative mitigation around "grandfathering" for the period of the annual contracts. Options might include short-period policies and automatic "cancel and rewrite".

Please contact your Marsh client executive if you would like to discuss this issue.

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