Brexit: beyond passporting

Implications for the UK insurance industry

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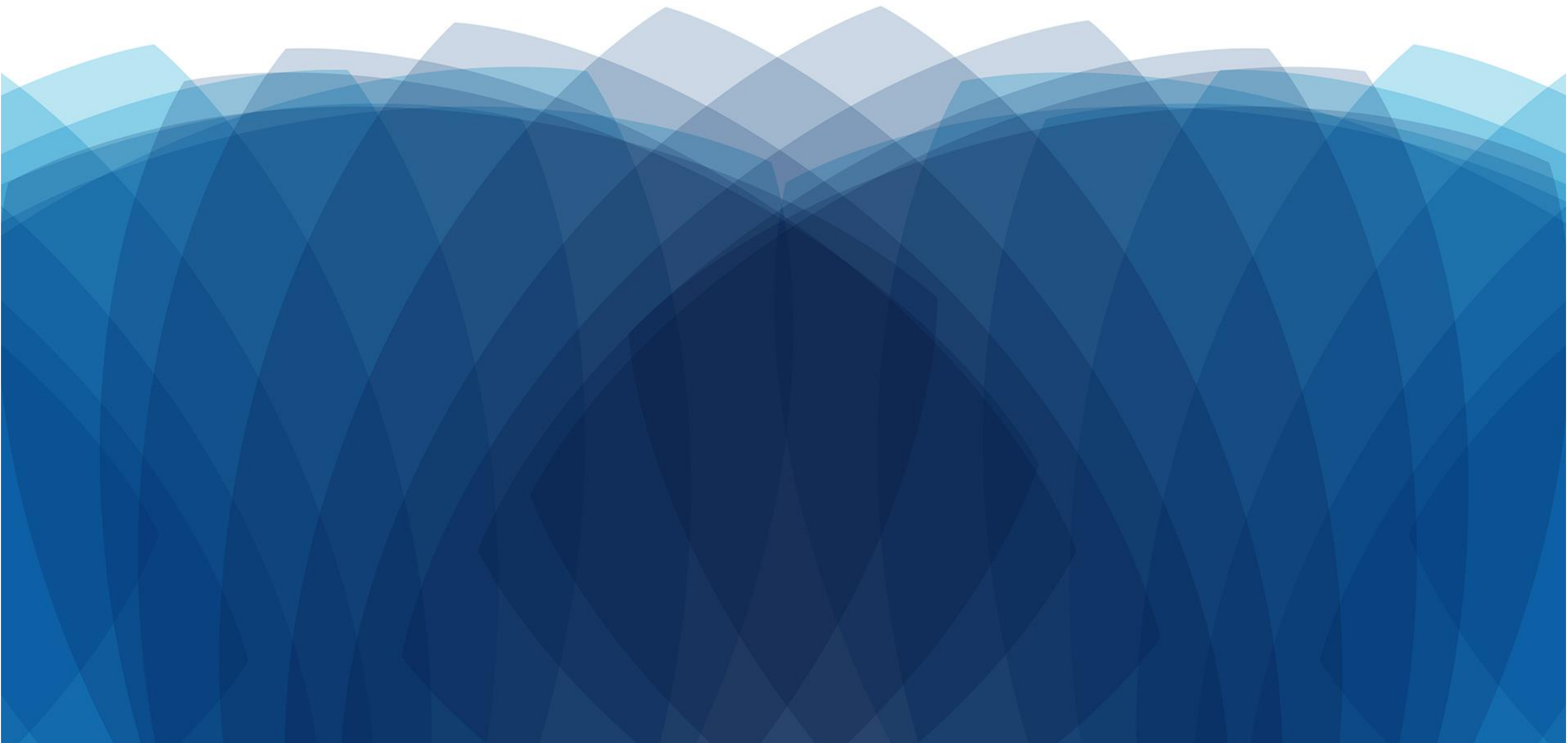

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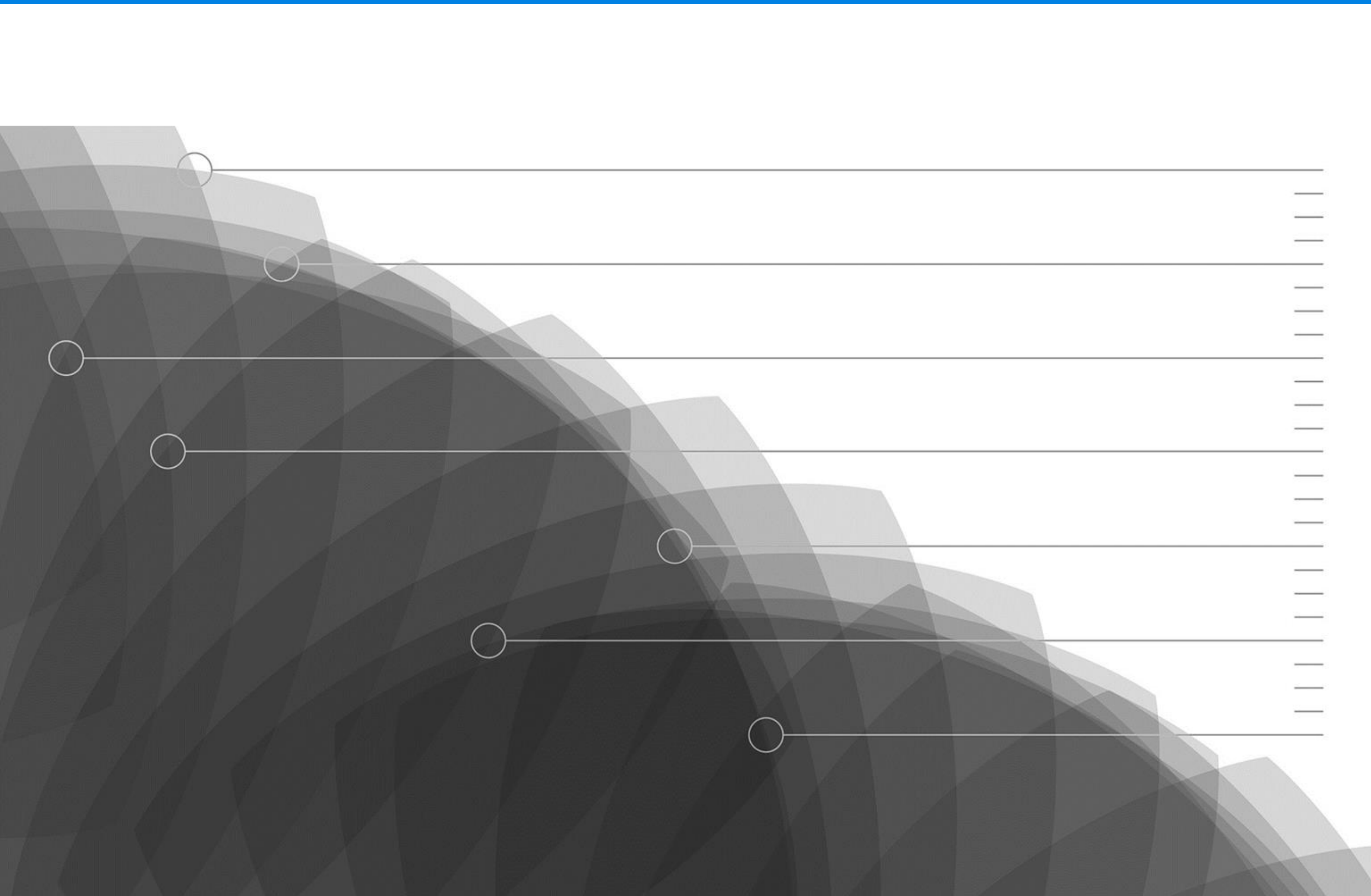
Introduction

The potential implications for UK-based insurers and insurance groups of ‘Brexit’ - the UK’s departure from the EU - go beyond the possible loss of the passporting rights which give UK financial services companies the right to operate across the European single market. Alongside the effects of a new trading agreement, the UK insurance industry could also be affected by legal and regulatory changes, political ramifications, or subtle demographic shifts all directly or indirectly associated with Brexit.

In this paper, we consider various future routes that the development of insurance regulation in the UK could take in respect of Solvency II and the impact each of these might have on UK insurers. We then highlight some of the other relevant areas of regulation and legislation that could be revised once the UK is no longer part of the EU, and also look at the challenges that UK insurers may face in the future when working with European insurance regulators. Finally, we review the extent to which insurers could be affected by any demographic changes driven by Brexit.



The UK and Solvency II

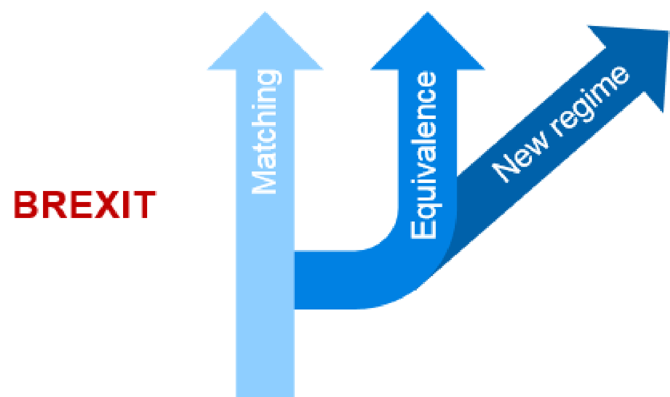
Regulatory developments

The future of prudential insurance regulation in the UK can be usefully framed in terms of the fate of the Solvency II regime. The UK is bound by the Solvency II rules until the formal exit from the EU is complete (potentially including any transition period), but from that point onwards the UK should have greater control over the design and implementation of insurance regulation. The degree to which the UK will be able to diverge from Solvency II, and other EU regulation, is likely to depend heavily on the nature of the final agreement between the UK and the EU. However, ignoring any possible restrictions, the potential future shape of UK insurance regulation can be viewed on a scale, with full ongoing adoption of Solvency II at one end and the introduction of a new, drastically different regime at the other.

In this paper we consider the three potential approaches to the future of UK insurance regulation that we believe to be the most plausible: 1) a regime that remains fully consistent with Solvency II including any subsequent changes, 2) a regime equivalent to Solvency II, and 3) a modified regime that (over time) diverges materially from Solvency II.

Full compliance with Solvency II

Figure 1. Potential approaches to regulation following Brexit



Under most foreseeable scenarios, leaving the EU need not necessarily have a direct impact on the shape of UK insurance regulation. The extent to which the principles of Solvency II (to increase harmonisation across Europe, to reflect the actual level of risk undertaken in the calculation of required capital, and to incentivise good risk management) are desirable in a post-Brexit UK should be considered. The UK is likely to remain invested in the latter two objectives, particularly as it was influential in the development of the regime, and many of the aspects of Solvency II are tailored to reflect the economics of insurance products sold by UK companies. This suggests, at a high level, that Solvency II could remain suitable for the UK. However, European harmonisation may no longer be as important a consideration for the UK. We note here that differences already exist with respect to the country level implementations of Solvency II, potentially suggesting that individual EU insurance regulators and supervisors have different interpretations of how the rules should be implemented, which necessarily affects the level of European harmonisation.

Maintaining the status quo by retaining Solvency II would ensure continuity of the regulatory environment for firms. Having only recently made the significant changes necessary to comply with Solvency II, insurers (along with their key stakeholders) are likely to have little appetite for yet another fundamental overhaul to insurance regulation. Such a change would likely carry high development costs, divert management attention, and could potentially lead to another dramatic shift in solvency positions across the industry. Of course, the benefit of continuing to follow EU insurance regulation from the perspective of avoiding significant development costs may only be short term in nature, for example if at some point the EU decides to make significant changes away from Solvency II in its current form.

By continuing to adhere to EU regulation, interactions between EU and UK insurance markets will continue to take place on an equal basis, allowing for meaningful comparisons across regulatory borders. For insurers that only operate in the UK and serve only UK customers, having a regulatory regime that is consistent with the EU may not be of great importance. However, for multinationals based in the UK (or with insurance businesses in the UK) retaining consistency with EU insurance regulation may be viewed more favourably.

Upon exiting the EU, the UK is unlikely to continue to serve as a voting member of the European Insurance and Occupational Pensions Authority (EIOPA) Board of Supervisors. This 'seat at the table' is essential in order to directly influence regulation and, without a UK presence in these processes, some of the aspects of Solvency II that were originally introduced with the interests of

UK insurers in mind may be at risk of change. EIOPA may suggest changes that are onerous for UK firms or, alternatively, propose changes perceived by the Prudential Regulation Authority ('PRA') as materially weakening the Solvency II requirements; these may be rejected by the UK regulator in favour of the stronger prevailing regulation. An 'observer' status may allow the UK to participate in discussions and shape the views of voting members, albeit to a lesser extent.

Solvency II equivalence

Solvency II equivalence may be granted in relation to comparable aspects (solvency calculation, reinsurance, and group supervision) of a regime outside of the jurisdiction of Solvency II on a temporary, provisional or full basis. This equivalence is granted by the EU commission, with the support of EIOPA. For example, the United States has been granted equivalence on a temporary basis, and the Bermudian and Swiss regimes currently have full equivalence.

By maintaining equivalence, the UK can avoid being subject to the rules and treatment of a 'third country' under Solvency II. Equivalence from the perspective of solvency would allow European Economic Area (EEA)-domiciled groups to assess the contribution of any UK entities to the group capital requirements using the local (i.e. UK) solvency regime. However, in the absence of equivalence these UK entities would have to determine their solvency positions on both a Solvency II basis (for group solvency) and using local rules for compliance with UK insurance regulation.

If Solvency II were to become more onerous than the prevailing UK regime, then UK subsidiaries of EEA-based groups might find themselves at a competitive disadvantage relative to domestic insurers. A similar situation would also apply to UK insurance groups with subsidiaries in the EEA, if the UK at some point in the future did not consider the EEA regime (Solvency II or otherwise) to be equivalent to the UK's regime.

Despite the UK adopting Solvency II from its inception, the approval process for equivalence may lead to a period where the UK does not hold equivalent status. These transition periods are often key points of negotiation and it may be possible for EIOPA to grant the UK a temporary or provisional equivalence during the period following the formal exit from the EU. This interim period may conclude with the UK gaining full equivalence. However, there is the potential for the UK to diverge from Solvency II during this phase and any changes arising in this period could influence the ultimate recommendation on UK equivalence.

Regime equivalence does not require the regimes to be identical; some of the current equivalent regimes employ a risk-based capital approach but differ from Solvency II at a more granular level or in other areas. For example, the risk groupings used to comprise risk modules, and the additional measures employed by firms within other equivalent regimes differ from Solvency II, as well as the solvency thresholds at which the regulator would intervene in a firm's operations.

One potential consequence of a UK regime that is equivalent, but not identical to Solvency II, is that it could result in an increase in the number of reinsurers establishing operations in the UK as they seek to transact with EEA insurers. A tailored UK regime may lead to less onerous capital requirements, allowing UK-based reinsurers to price more competitively than those directly subject to Solvency II, whilst an equivalent status would give them beneficial treatment when serving EEA insurers. The presence of reinsurers serving EEA insurers is a feature of other Solvency II-equivalent regimes and therefore it is possible that a similar effect could be observed in the UK.

Deciding on whether or not a regime is equivalent is likely to have been quite challenging for the regimes that are not readily comparable with Solvency II. However, given that the UK currently adheres to Solvency II, it should be much more straightforward to assess whether a revised UK regime remains equivalent, at least initially where any changes that are made are relative to Solvency II as a starting point. However, as changes in the UK regime can be directly compared to the Solvency II requirements, differences between the regimes may be more evident, and this may make maintaining equivalence harder for the UK.

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Differences between EU and UK insurance regulation could emerge via two routes: 1) if the UK decides not to adopt new or amended EU regulation locally, or 2) if the UK makes its own changes to the existing domestic regulation (that are not mirrored in the EU). Whether any differences (either in isolation or collectively) are sufficient for the European Commission to decide not to grant equivalence, or to remove it at a later stage, will depend on the extent to which the UK regime continues to satisfy the equivalence criteria set down in the Solvency II Delegated Regulation.[1] A desire to maintain equivalence may therefore be a

[1] See Articles 378, 379, and 380 of the EU Solvency II Delegated Regulation: http://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:32015D1602&from=EN

limiting factor to the extent of any regulatory changes post-Brexit. However, it is reasonable to expect that the PRA should have some scope for making changes to the regulatory regime that do not violate the equivalence criteria.

There are number of areas of the Solvency II regime, such as contract boundaries rules, asset look-through requirements, and the treatment of derivatives, where firms still struggle to know exactly how to interpret and therefore comply with the rules, and in some cases this has led to inconsistency and uncertainty across the UK insurance industry. It is ultimately the responsibility of a company's board to form a view on the appropriateness of a given approach, but regulatory guidance or clarity around the PRA's expectations are still very useful to firms. Even if the PRA makes no (immediate) changes to the rules for insurance regulation, the UK's departure from the EU may prompt it to rethink its approach to providing guidance as to how the rules should be interpreted by UK insurers.

Whilst the UK remains in the EU, the PRA's approach in this regard is likely to be informed by the need to be consistent with guidance issued by EIOPA and it may be wary of issuing guidance that is weaker than, or goes beyond, the interpretation followed elsewhere in the EU. Brexit may therefore be a driver of the PRA issuing further guidance or clarification to UK insurers in relation to contentious or uncertain areas of the Solvency II rules. The additional freedom afforded by Brexit may also prompt the PRA to take a harder (or softer) approach to what it considers to be permissible under the rules. Purely by way of example, it could relax its approach to Matching Adjustment asset eligibility in a way that it considers to still be consistent with the Solvency II rules.

From an insurance regulation perspective, many market participants are likely to view a fully equivalent regime as the optimal outcome of Brexit. Such a scenario would provide the UK with some freedom to change the aspects of Solvency II that are not considered to be appropriate or relevant to UK firms, but would also serve to limit any costs that might otherwise arise in relation to complying with new rules or producing an additional set of balance sheet results.

A new regime

At some point after the UK has formally left the EU, it is conceivable that the PRA could propose an entirely new regulatory regime for UK insurers. In the short term, this would be challenging for the regulator given the level of work and resource that would be required internally, and, given the financial burden and industry turbulence associated with implementing Solvency II, such a move may result in opposition from the UK insurance industry.

Firms continue to embed and refine their approaches to satisfying the Solvency II rules and, alongside this and day-to-day business-as-usual activity, UK insurers may also be working actively on a number of other areas. This will include preparing for International Financial Reporting Standard (IFRS) 17, developing (full or partial) internal models, and managing Matching Adjustment portfolios. There is therefore unlikely to be a vast amount of underutilised resources ready and waiting to implement yet another new regulatory framework.

Aside from the unwanted costs and distraction associated with a new regime so soon after Solvency II has come into force, and despite some not insignificant issues with certain aspects of the Solvency II requirements, there does not currently appear to be great demand for a wholesale regime overhaul. Furthermore, it is not immediately evident that the PRA would propose a fundamentally different regime, given the level of UK involvement in the development of Solvency II, and the broad similarity between Solvency II and the previous UK Individual Capital Adequacy Standards (ICAS) regime. The PRA was intimately involved in the design of Solvency II (via its membership in EIOPA), as was the UK insurance industry via its participation in the Quantitative Impact Studies, consultation processes, and preparatory phase.

Outside of a major crisis in the UK insurance industry that exposes significant failings in the current regulatory regime, in our view it is more reasonable to expect that any new regime (post-Brexit) will emerge from a gradual 'drift' (potentially in the form of a series of step changes) away from the Solvency II rules. The evolution of UK regulation may ultimately result in EIOPA revoking any equivalence status granted, at which point the UK would be viewed as then having a distinct regulatory regime. It should be noted that the UK may form its own view of equivalence over time, and material differences may cause the PRA to no longer view Solvency II as an equivalent regime.

As noted in the previous section, over time an increasing divergence between the EU and UK regimes could be caused by a combination of:

1) Amendments or additions to the UK regulatory framework that are instigated by the PRA (perhaps in response to government or industry pressure).
2) Conscious decisions by the UK not to follow or match changes made to the EU regulatory framework.

The future of UK insurance regulation

Accepting the uncertainties associated with the pace at which any changes might be implemented, and the extent to which these changes could move the UK regime outside of equivalence, it is nevertheless informative to consider which areas have the potential to be revised. Unsurprisingly, we would expect any changes to focus on addressing the main issues that the PRA and the UK insurance industry have with the current regulatory framework.

In February, the PRA published a response to the Treasury Committee's inquiry into Solvency II,[2] which outlined several areas where the PRA and the UK insurance industry both see potential merit in diverging from the current Solvency II regulations and EIOPA guidelines. The response indicates specific areas which could potentially be revised post-Brexit, and we have highlighted some notable examples below.

The risk margin

The calibration of the risk margin is considered by many to be poorly suited to the UK insurance market, in particular with regard to the prescribed cost of capital rate, the classification of longevity risk as a non-hedgeable risk and the risk margin's sensitivity to movements in risk-free rates. The PRA is currently considering potential methods for addressing these issues within the constraints of Solvency II but may be expected to consider more substantial changes unilaterally post-Brexit.

Contract boundaries

There are currently differences in the definition of contract boundaries between Solvency II and standard accounting practice, notably IFRS 17.

The amount of flexibility given to insurers

This relates in particular to the perceived lack of flexibility around the characteristics required for assets to be eligible to attract the Matching Adjustment. The current requirements can often result in firms restructuring assets in order to make them, at least partially, eligible.

In addition, there may be appetite within either the industry or the PRA for regulatory changes in relation to other areas such as:

The treatment of risk mitigation strategies

Many consider it not obvious how the rules regarding the treatment of such strategies should be applied within the calculation of the Solvency Capital Requirement (SCR), for example where derivatives are held in unit-linked funds. In addition, the conditions for taking credit for risk mitigation techniques in capital requirements are considered by some to be overly onerous.

The asset look-through requirements for collective investment vehicles

These currently add an additional layer of data requirements and complexity to asset reporting; however many consider that asset look-through does not add sufficient value for it to be proportionate. In particular, the asset management industry has expressed concerns regarding the additional costs and complexities involved in providing this information.

Elements of the Standard Formula calculation

Changes could be made, for example, to recalibrate certain risk modules in order to bring them up to date and make them more relevant to the UK market. The PRA has also indicated that there may also be scope for the inclusion of additional risk modules such as inflation risk, as well as spread and concentration risk charges for EU government bonds.

It is possible that some or all of the areas described above could be incorporated into the Solvency II regime at a European level, although changes may be effected more quickly or in a way that is more relevant to the UK insurance market under a regulatory regime that diverges from Solvency II. However, as discussed in previous sections, depending on the extent to which any proposed unilateral changes diverge from Solvency II it is possible that they could be made whilst still retaining equivalence, meaning that the regime could be tailored to the UK market without necessitating a distinct, non-equivalent regime.

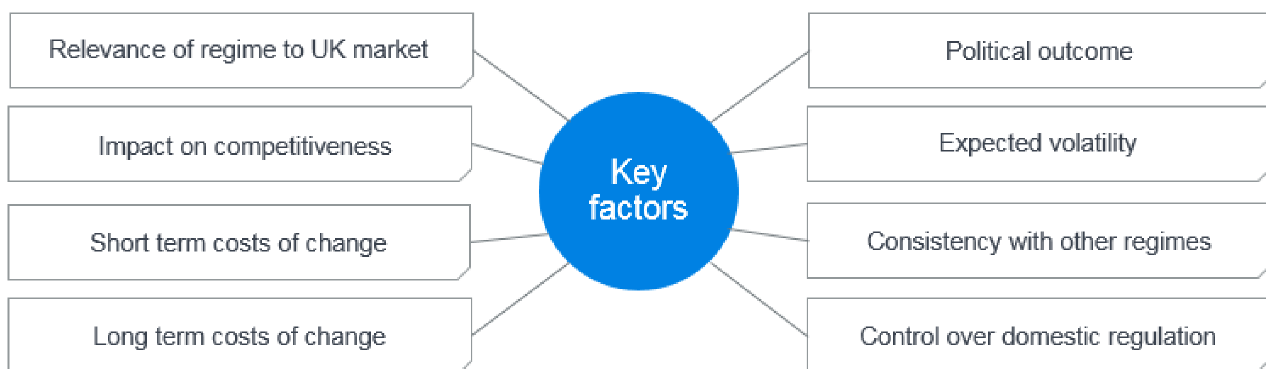
Any changes to the UK regulatory regime for insurers will clearly affect UK insurers serving the home market, but such changes may also make it easier (or indeed more difficult) for UK insurers to operate competitively in overseas markets. In addition, we may find that changes to the UK regime will influence the desire of non-UK multinational insurers to maintain their UK subsidiaries.

[2] Bank of England (27 February 2018). PRA Response to the Treasury Committee's Inquiry into Solvency II. Retrieved 12 April 2018 from https://www.bankofengland.co.uk/prudential-regulation/publication/2018/pra-response-to-the-treasury-committees-inquiry-into-solvency-2.

In our opinion, firms should not expect or plan for regulatory changes following Brexit that materially weaken the rules or make the regime less onerous. A historically prudent PRA, whose primary objectives are to promote insurers' safety and soundness and to contribute to securing an appropriate degree of protection for policyholders, is unlikely to make changes that put these objectives at greater risk. Nevertheless, changes could be made in a way that tailors the regulatory regime more to the UK insurance industry without sacrificing the protection it affords to consumers.

Figure 2 outlines some of the key factors that could influence potential post-Brexit regulatory approaches.

Figure 2. Key factors influencing potential future regulatory approaches



The UK and other EU law

Solvency II isn't the only EU import

Thinking beyond Solvency II, although relevant aspects of EU law will initially be transposed into domestic UK law via the UK's European Union (Withdrawal) Bill, Brexit gives the UK the freedom to 'keep, amend or repeal'[3] individual elements of legislation inherited from the EU going forwards.

There are several potential changes that may affect insurance companies; in the shorter term these could be viewed as fitting into one of five categories:

1) Existing EU laws that are currently considered acceptable within the UK, and for which currently there is no major incentive to alter.

2) Existing EU laws (such as gender-neutral pricing) where there may be arguments for altering, although there may be practical or political barriers to doing so.

3) Existing EU laws (such as the regulation relating to Packaged Retail Investment and Insurance-based Products (PRIIPs)) around which there are currently concerns, and which the UK may wish to unwind or alter once it is able.

4) Recent or pipeline EU laws (such as the General Data Protection Regulation (GDPR)) that are still intended to be implemented and where alterations are not currently considered necessary.

5) Recent or pipeline EU laws (such as the Insurance Distribution Directive (IDD)) that the UK may wish to unwind or alter once it is able.

Over the medium to long term, the opinions of the UK government and public are likely to change, and therefore the UK may choose to amend or repeal an increasing number of existing laws, or to bring in new laws that are inconsistent with the EU laws at the time of Brexit. In the boxes overleaf, we have outlined our thinking for each of the examples.

[3] Department for Exiting the European Union (March 2017). Legislating for the United Kingdom's Withdrawal from the European Union. Retrieved 12 April 2018 from https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/604516/Great_repeal_bill_white_paper_accessible.pdf.

Gender-neutral Pricing

Gender-neutral pricing was introduced into EU law in 2012. This legislation currently prevents EU insurers from using gender as a rating factor when setting premium and benefit levels, on the grounds of gender discrimination. Gender is arguably a highly credible rating factor, and the implementation of this legislation has been claimed by many to have introduced a cross-subsidy, resulting in increased prices for males in some cases, and females in others. Many consider that, at an overall level, gender-neutral pricing may have harmed the commercial viability of certain products.

Whilst there may be logical reasons from both a consumer and insurer perspective to restore gender as a permissible rating factor, such a change might nevertheless be viewed unfavourably and could therefore be politically difficult to implement.

Insurance Distribution Directive

The IDD sets out enhanced information and conduct of business requirements in relation to the distribution of insurance products. It is due to apply from October 2018 and will therefore already be in force by the time of the UK's exit from the EU.

In some areas, the existing UK rules in relation to the sale and marketing of insurance products are considered to be stricter than the minimum requirements of the IDD. If, following implementation, the Financial Conduct Authority (FCA) considers that the IDD requirements are unnecessary and place an undue burden on firms without a material benefit to consumers, then it is not inconceivable that it could look to unpick some of the requirements of this new EU directive.

PRIIPs

New EU-wide rules regarding customer illustrations and transparency requirements for PRIIPs came into effect in January 2018. These rules prescribe the information that must be provided within illustrations, the method of calculation in relation to projected returns, and the different performance scenarios that must be included.

Both in the run-up to, and since, the implementation of the new PRIIPs rules, concerns have been raised within the insurance industry that, in certain instances, the requirements can lead to overly optimistic illustrations and that they have '*the potential to mislead investors.*'[4] Some consider the more heavily prescribed rules to be a step backwards compared to the FCA rules and guidelines that applied previously.

In January, the FCA acknowledged these concerns and permitted firms to provide additional information to customers in order to supplement the prescribed illustrations and provide clarification. However, such an approach may not be a satisfactory long-term solution as the provision of additional information has the potential to confuse consumers. Much like the IDD, if the PRIIPs requirements are not considered to be in the best interests of consumers, then the FCA may choose to address these issues unilaterally following Brexit, although the requirements are likely to still have to be followed for business sold into the EU.

GDPR

Insurers hold a significant amount of personal and sometimes sensitive information about their policyholders. Compliance with the forthcoming GDPR, which sets high standards for the use and protection of data, is therefore likely to be particularly onerous for the UK insurance industry.

The UK government has issued a statement of intent[5] regarding the adoption of the GDPR into UK law via a new Data Protection Bill, and so the rules are expected to already be a part of UK law by the time the UK exits the EU in 2019. Subsequent to its departure, the UK may then have the freedom to change the laws that apply domestically in relation to the management, storage and protection of consumer data, which in theory might include weakening or unwinding the rules introduced by the GDPR.

The primary intention of the GDPR is to improve customer protection. From an international perspective, it is likely to be counterproductive for the UK to have weaker standards than other countries. GDPR does not therefore appear to us as an area that would be revised after Brexit.

In addition, following Brexit the UK may no longer fall within the scope of existing cross-border data agreements held by the EU, and therefore could be required to forge new deals with the US and other countries. This could present the UK with an opportunity to enter into tailored agreements that support and encourage international collaboration to a greater extent than the existing EU agreements. Although there may still be regulatory and other barriers to overseas data transfers in the future, the more extensive data transfer options that could result from these new data agreements may enable insurers to access and embed technological developments currently only available overseas into their business, for example infrastructure in the US which currently may not be fully accessible due to EU data restrictions. Therefore, new data agreements could potentially result in improved operating efficiencies and customer service capabilities, as well as enhancing firms' ability to work collaboratively with overseas subsidiaries.

New environments, new regulators

Capacity and capability of foreign regulators

The potential loss of passporting rights post-Brexit is likely to mean that branch operations in EU countries are no longer sufficient to enable UK firms to service business within the EU. UK insurers are therefore likely to have to set up new EU-based subsidiaries or branches, or transfer overseas business to existing EU-based subsidiaries or branches in order to continue to service EU business. Redomiciling and interacting with overseas regulators is likely to present new challenges for many UK insurers, particularly for firms whose main regulatory experience is a longstanding relationship with the PRA. In July 2017, EIOPA published its 'Opinion on Supervisory Convergence in light of the United Kingdom withdrawing from the European Union'[5], which made several key points regarding its intended approach to UK firms looking to apply to relocate all or part of their businesses to an EU member state following Brexit:

- There should be no automatic recognition of authorisations granted by the PRA, i.e. firms relocating to the EU are likely to be required to reapply for any existing authorisations or Solvency II approvals.
- 'Letterbox'-style subsidiaries, where a firm is officially based within one country but in practice the majority of its operations take place in a different country, should not be permitted.

In order to avoid any perception that an insurer is running a letterbox-style operation in another country, firms are likely to be expected to demonstrate that an appropriate and proportionate level of 'corporate substance' exists within that country, including the presence of board members, key function holders, and a sufficient level of local staff. It is expected that supervisory authorities will closely scrutinise any material transfers of risk (away from the EU country in question) in the context of the firm's business model and risk management capacity, and it is suggested that a minimum of 10% of the business written[6] be retained within the member state. The latter point suggests that EIOPA wishes to preclude firms from circumventing the rules that will apply following the loss of passporting requirements through intra-group reinsurance arrangements.

Given the level of scrutiny required and the likely volume of applications, regulators in more popular relocation destinations such as the Republic of Ireland may reach capacity in the run-up to Brexit; therefore there is potential for the authorisation of subsidiaries and insurance business transfers to be delayed. It is therefore particularly important that insurers wishing to relocate or set up an EU subsidiary approach the regulator in their preferred EU member state within an appropriate timescale; arguably they should already have done so.

"…overseas insurance regulators may well adopt a different approach to regulation and supervision compared to the PRA and FCA."

Firms should also bear in mind that overseas insurance regulators may well adopt a different approach to regulation and supervision compared to the PRA and FCA. Other national regulators may have different ways of interacting with firms, and may hold firms to higher (or lower) standards or place a greater focus on different areas. For example, they may have different approaches to Solvency II approvals compared to those that firms have experienced in the UK. Furthermore, EU regulators may also have different priorities, and insurance markets in other European countries may well have different overall risk profiles as a result of different products and investment strategies. This may affect the regulators' appetite for permitting new firms or subsidiaries which take on certain types of risk.

It is also worth remembering that the UK insurance market is fairly mature and sophisticated relative to some other EU countries, and UK firms have developed their approaches to certain aspects of Solvency II with a regulator (the PRA) that reflects this. Timescales should therefore allow the overseas regulator to familiarise itself with the models and methodologies used.

Shifting markets

Following Brexit, the UK is likely to look to strengthen its relationships with other countries. Internationally-focussed UK businesses will be heavily affected by the trading conditions that emerge post-Brexit, and if there are problems or delays in negotiating beneficial trade deals then companies that rely on the export and import of goods or services are likely to undergo

[4] FCA (24 January 2018). Statement on Communications in Relation to PRIIPs. Retrieved 12 April 2018 from https://www.fca.org.uk/news/statements/statement-communications-relation-priips.

[5] EIOPA (11 July 2017). Opinion on Supervisory Convergence in Light of the United Kingdom Withdrawing From the European Union. Retrieved 12 April 2018 from https://eiopa.europa.eu/Publications/Opinions/EIOPA-BOS-17-141%20Opinion_Supervisory_Convergence.pdf.

[6] EIOPA suggests that the ratio of gross technical provisions to might provide an indication of the amount of business retained

difficulties. To the extent that UK insurers are invested in equity or debt issued by such firms, changes in trade deals could therefore have an impact on the creditworthiness of their asset counterparties, particularly those in sectors such as manufacturing. Firms may wish to consider the impact this could have on their risk exposures and solvency.

Insurers may also wish to consider the opportunities that may be afforded to them by improved commercial relationships with other countries and consider expanding into markets such as Asia and the US. Similarly, EU insurers may decide that the UK is no longer a viable market for them and withdraw, leaving gaps in the market or reducing competition which could potentially open up growth opportunities for UK insurers or proactive insurers based in non-EU overseas territories that have struck trading deals with the UK following Brexit.

Changing demographics

Sun, sea and retirees

There are an estimated 1.2 million UK nationals currently living in EU member states other than the UK, with around half of these living in retirement. If no deal on the provision of financial services is agreed between the UK and the EU, insurers that have not taken steps to address the problem (for example, by setting up an EU subsidiary) may be unable to make payments directly to any UK annuitants living overseas. There are many reasons why retirees may return to the UK after the formal exit from the UK, and difficulty around receiving retirement income may become an important factor. Such a change may not (in isolation) have a direct impact on insurers, but it may have an influence upon a number of areas indirectly related to insurance, some examples of which are:

- There may be a greater strain placed on the National Health Service (NHS) and other care and support services from an increase to the size of the retired population, particularly when combined with any resource issues associated with the potential loss of EU workers. This could be one of a number of contributing factors that spur life and health insurers to develop the market for insurance and savings products that fund private health care provision further.
- The return of relatively affluent retirees could put further demand side pressure on the UK housing market, particularly in areas popular with older generations.

The UK workforce

Between 2007 and 2016, Office for National Statistics figures suggest a gross migration of 1.8 million individuals from EU member states to the UK took place. Depending on the immigration approach agreed between the EU and the UK, the much signalled end of the free movement of labour following Brexit may have a significant effect on the supply of labour in the UK. The process for EU nationals to come to live and work in the UK will (under most scenarios) be more difficult than it is today. At a macro level, any loss of immigrant labour may result in a drag on economic growth due to the reduction of resources available to the UK economy.

The UK is not, however, solely reliant on EU labour in the workforce. Over the same 10 year period, immigration from outside the EU is estimated at 2.6 million, 40% greater than that from within the EU. Freedom of movement is not a right for these individuals, yet approximately 1.2 million individuals from outside the EU contribute to the UK workforce. It is possible that, given a reduction in labour from the EU and a consistent demand for labour, the UK may draw more heavily upon labour from outside the EU. As the UK begins to explore trade deals with other nations, the availability of visas may form an important aspect of the negotiations, providing further sources of labour for the UK economy.

The situation is also uncertain for UK nationals currently working in the EU. The rights of those already living or working in EU member states after the UK exit is highly debated on both sides. There are an estimated 500,000 UK nationals working in EU countries other than the UK, and a further 100,000 under the age of 15, assumed to be dependants. Any loss of rights would be a powerful driver of repatriation; the return of this combined group of 600,000 would provide an increase in the labour supply within the UK economy, while increasing the demand on schools and other provisions for children.

The loss of EU labour, the return of UK citizens who currently live overseas and greater potential non-EU immigration represent future drivers to UK demographics. The net position for the UK population depends on each of these drivers, and the time period over which this takes effect depends critically on what is agreed in this area in any final Brexit deal and subsequent treaties. Insurers may benefit from assessing the impact of changing demographics on the demand for products, and explore new products that can be developed to service growing market segments. The potential loss of skilled EU personnel should be considered within their risk management processes and strategic planning, and how future processes may capitalise on new sources of expertise.

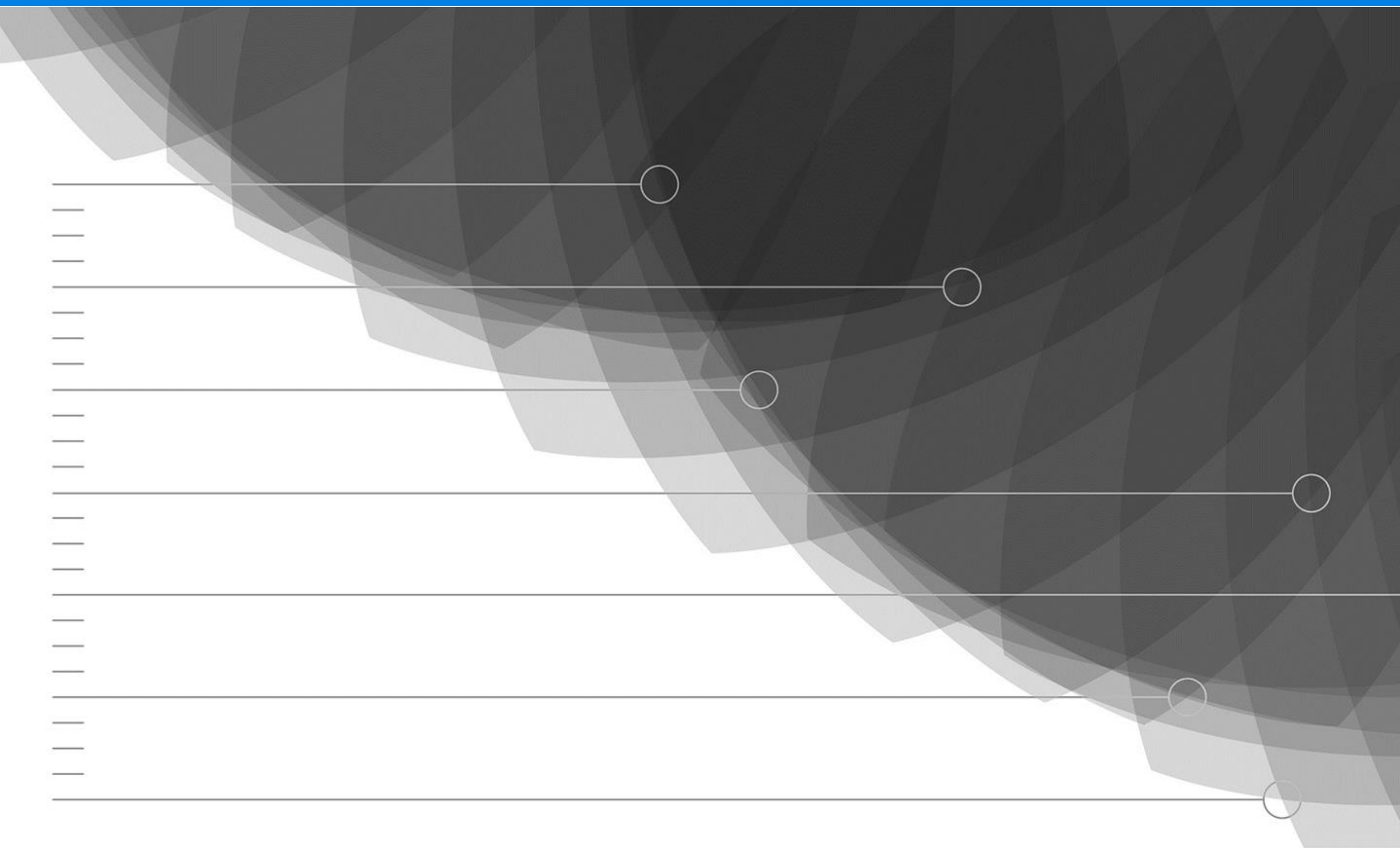
Conclusion

There is still a great deal of uncertainty surrounding the deals on trade, immigration, and other key areas that will need to be negotiated between the UK, the EU and other countries now that the UK is leaving the EU. Similarly, it is difficult to predict with any real certainty what changes (if any) will be made to UK laws, rules and regulations in the period after Brexit.

We have observed that some UK insurers are taking a very proactive approach to addressing the challenges associated with no longer being part of the EU, whilst other insurers seem to prefer a 'wait and see' approach, particularly those that do not have policyholders residing in other EU countries. As we have discussed in this paper, however, the possible repercussions of Brexit go beyond the potential loss of passporting rights, and could have very real consequences for the whole of the UK insurance market, particularly in relation to the regulatory environment. In our view, all firms should therefore be considering the range of plausible outcomes and considering response strategies as part of their risk monitoring and management processes.

Brexit is both an emerging risk and an emerging opportunity. Firms that are proactive, that consider and develop appropriate strategies for each possible outcome, and that prepare for the shifting markets should be well placed to address the challenges that do arise and to take advantage of any opportunities presented.

With offices in principal cities worldwide and a team of risk management specialists in London, Milliman can work with you to position your firm to be one of the companies that thrive in the post-Brexit era.



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