Legal high Committee for
Financial markets of Paris

REPORT ON THE IMPACT OF BREXIT ON INSURANCE ACTIVITIES

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12 September 2018

9 rue de Valois 75001 Paris - Tél.: 33 (0)1 42 92 20 00 - hautcomite@hcjp.fr - www.hcjp.fr

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INTRODUCTION

On 29 March 2017, the United Kingdom formally initiated the withdrawal process from the European Union ("**EU**"), thereby operating what is commonly referred to as Brexit. From the date of its entry into force on 29 March 2019, and in the absence of a withdrawal agreement setting a later date, the United Kingdom will cease to be directly subject to the rules of the European institutions. This entails, in particular, that entities established or operating in the United Kingdom will no longer be subject to the applicable European insurance rules and will no longer benefit from them.

This raises questions about the impact of Brexit, both from the EU and UK operators perspective[1]. These consequences are of particular importance given the economic interactions between the United Kingdom and the EU regarding insurance, irrespective of the activity in question. In addition, those consequences entail financial stability and legal certainty issues for Europe and the operators in the insurance industry.

In this context, the *Haut Comité Juridique de la Place Financière de Paris* (*High Legal Committee of the Paris Financial Centre* "**HCJP**") set up a working group to (i) examine the impacts of Brexit on the activities of insurance undertakings as well as the continuation of outstanding contracts and (ii) make recommendations to ensure a harmonised application of regulation among EU Member States and the prevention of regulatory imbalances and circumventions.

The analysis focused on direct insurance entities, excluding reinsurance institutions for which even if Brexit will affect their activities, the difficulties raised are less significant (see below). In addition, it has been decided to take the perspective of British insurers intervening in France, rather than the one of French insurers operating in the United Kingdom. Furthermore, this report makes the assumption of a withdrawal without specific arrangement regarding insurance ("hard" Brexit).

The HCJP's analysis and recommendations therefore address the impact of a hard Brexit:

- on the one hand, on the regime applicable to insurance undertakings, and more specifically to British insurers operating in France (**1**);
- on the other hand, on the regime applicable to outstanding contracts, especially contracts underwritten with British insurers on risks or liabilities located in France (**2**).

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[1] *Developments in the United Kingdom also apply to Gibraltar.*

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SUMMARY

I - The immediate consequence of a "hard" Brexit: the loss of passports of UK entities located in the United Kingdom

Following the negotiations on the exit of the United Kingdom from the European Union[2], the loss of the European passport for UK insurers is likely to occur. The European passport grants the freedom to provide services and the freedom of establishment. It allows an institution authorised in one of the Member States of the European Union to provide services within the territories of other EU Member States without having to establish a locally-authorised subsidiary. It also allows an institution authorised in one of the Member States of the European Union to establish a branch in another Member State without needing to apply for authorisation to the host State. The European passport thus provides unique access to the markets of the different EU Member States.

There is no European regulation that specifies the legal consequences of the loss of passport on contracts entered into before Brexit. The question arises as to whether this loss may be considered as a withdrawal of authorisation, withdrawal being an individual administrative act sanctioning an operator's inability to retain such authorisation, whereas the loss of the passport resulting from Brexit takes place within the collective framework of a political decision of the United Kingdom. The loss of the passport for UK insurers is thus an unprecedented situation, for which the HCJP intends to clarify the consequences.

The loss of the passport should not result in the invalidity (*ab initio*) of the contracts validly entered into before Brexit under French law: the principle of performance until its maturity of a validly constituted contract must therefore be fully applied[3].

However, the loss of passport would prohibit the relevant operators from undertaking new commitments towards customers located in Europe. Any renewal of contracts at maturity, including tacit renewal, and any substantial change in the obligations of the Parties to any contract validly subscribed prior to Brexit shall be treated as such new commitments. For example, a substantial change could include the addition of new guarantees to those previously agreed, or the increase in the value of existing liabilities or more generally any change that result in an increase in the insurer's liability.

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[2] The concept of "Brexit" can refer to several dates: the date of the outcome of the referendum in the United Kingdom, the date of notification of Article 50 of the Treaty on European Union and the date of the effective exit of the United Kingdom from the European Union. The relevant working group considered that the date to be taken into account is that of the effective exit of the United Kingdom from the European Union.

[3] However, some contracts could be deemed invalid (no effects for the future).

The working group has confronted two analyses on the characterization of the management of outstanding contracts after Brexit.

The first analysis shall retain the characterisation of insurance activity for that purpose. Supported by an EIOPA opinion of December 2017 interpreting the Solvency 2 Directive, which has been included in the European Commission opinion of February 2018, this position considers that a UK insurer that would perform its commitments after Brexit, would engage in the illegal exercise of insurance activity[4]. This would imply that the liabilities of UK insurers taken towards European policyholders should be transferred to entities authorised in Europe.

The second analysis is that the management of an insurance contract is underwriting a new commitment but only managing the consequences of an already validly-agreed commitment. This implies that a UK insurer performing subsequent obligations to a contract entered into before Brexit, notably by managing claims settlement, would not breach any legal or regulatory provisions. The Luxembourg regulator supported this interpretation.

II - Under current regulations, solutions exist to address these challenges

2.1 - Outstanding contracts

The transfer of portfolios to entities located in the European Union is a first solution, but there is no unified European regime for the transfer of contracts and the mechanisms of domestic law are often characterised by their burdensome nature.

On the other hand, in particular regarding insurance, the transfer of contracts to EU entities would be subject to long UK procedures which fall within the jurisdiction of the Courts of the United Kingdom, and would involve action by *the Prudential Regulation Authority* (PRA) as well as consultations with the authorities of the relevant countries[5].

[4] *C. ass, Art. L. 310-27: "Carrying on in the territory of the Republic one of the operations mentioned in 1°, 2° and 3° of Article L. 310-1 without complying with the provisions of Articles L. 310-2 and L. 310-6, shall be punishable by three years imprisonment and a fine of EUR 75,000."*

[5] *Directive 2009/138/EC of the European Parliament and of the Council of 25 November 2009 on the taking-up and pursuit of the business of Insurance and Reinsurance (Solvency II), Art. 39.*

Moreover, European regulators do not have the power to force UK insurers to make such transfers.

2.2 - Future contracts

The loss of the European passport requires UK insurers, if they want to continue to operate in the EU, to set up an entity authorised in the Union (subsidiary, European company and, less likely, branch). Some functions can be outsourced from this entity in the EU to the United Kingdom.

The outsourcing regime, which implementation remains national, raises concerns that some Member States would be more flexible than others in the application of this regime. If the European framework resulting from Solvency 2 Directive seems to impose sufficiently significant constraints on the outsourcing of operational functions or activities, its effectiveness should be ensured. This regime, which is being applied too softly, will not incentivise UK insurers to transfer their European business under the jurisdiction of the European supervisory authorities.

III - Recommendations

3.1 - Outstanding contracts

Regulations could usefully be taken by national authorities, with the aim of removing uncertainties regarding the execution of contracts entered into before Brexit by European customers with UK operators[6].

Two alternatives were finally envisaged:

- The first would be to differentiate between the outstanding portfolios which extinction would occur, for example, within 5 years from the end of the transitional period, and those which extinction would occur beyond. Contracts with the shortest commitments would therefore have to be managed from the UK entity until their extinction. On the contrary, the longest commitments

[6] *For illustrative purposes, the estimated amounts of the aggregated technical provisions of UK and Gibraltar insurers at the end of 2016 were as follows:*
- Life insurance: EUR 89 million;
- Fire, natural elements and other damage to goods (classes 8 and 9 Solvency II): EUR 1,320 million;
- General liability (class 13): EUR 4,940 million;
- Motor liability motor vehicles (class 10): EUR 630 million;
Other non-life insurance classes: EUR 1,056 million.

should be subject to a transfer to the benefit of entities authorised in Europe, otherwise for the English insurer would be exposed to criminal sanctions for the illegal exercise of insurer activity.

- The second, having the HCJP's preference, would be that the existing regulations on the lapse of authorisations should be adapted to include the situation of loss of the European passport. The ACPR's recognition of the loss of the passport would result in the relevant entities being subject to the ACPR supervision for the discharge of the contracts underwritten via this passport, including through the establishment by the insurer and jointly with the ACPR of a programme for liquidating commitments.

3.2 - Future contracts

The HCJP underlines the necessity to start a discussion at the European level on the opportunity to set uniform requirements for outsourcing important or critical functions.

Such discussion could also extend to the opportunity to introduce appropriate supervision under the aegis of EIOPA for the implementation of the supervisory framework by national authorities.

PRESENTATION

I - Brexit's impact on insurers' regime

The *Haut Comité* examined the regime applicable to UK insurers operating in France when, following Brexit, the United Kingdom will become a third country.

Unlike insurers, reinsurers with head offices in a third country may benefit from an equivalence regime to carry out their activity with French insurers[7]. Indeed, when the European Commission decides that the solvency regime of a third country is equivalent to that set out in Directive 2009/139/EC of 25 November 2009 ("**Solvency 2 Directive**"), reinsurance treaties entered into with companies of that country are considered as reinsurance treaties entered into with undertakings authorised in the EU[8]. In principle, the treatment of such undertakings cannot be more favourable to the treatment reserved to European reinsurers; certain conditions are reserved to them which may provide for the obligation to guarantee their commitments towards reinsured undertakings[9]. This equivalence mechanism will significantly reduce the impact of Brexit on reinsurance entities established in the United Kingdom and intervening with French insurers.

On the contrary, in the absence of an equivalence mechanism, Brexit will have much more impact on UK insurers currently operating in France under the regime of European passport.

In this respect, the consequences of the loss of this passport (1.1) should be assessed before the different solutions are examined (1.2). The effectiveness of the chosen solutions should take into account the ability of European entities to outsource certain services outside the EU (1.3).

1.1 - The loss of the European passport

In order to carry out their business, EU insurers must seek authorisation from the supervisor of the Member State where they have established their head office[10]. Such authorisation shall be granted for the operations of one or more of the life or non-life insurance classes identified in Annexes 1 and 2 of the Solvency 2 Directive[11]. Once authorised in its home State, the insurer benefits from

[7] *C. ass, art. L. 310-1-1 III 3°.*

[8] *Dir. 2009/138/EC, Article 172 (3).*

[9] *Dir. 2009/138/EC, Article 174.*

[10] *Dir. 2009/138/EC, Article 14 and s.*

[11] *Comp C. ass, art. R. 321-1.*

the European passport which offers it the freedom to operate in other EU Member States under the freedom of establishment or under the freedom to provide services ("**LPS**")[12].

It is therefore pursuant to this passport that insurers established in the United Kingdom may cover (non-life) risks or underwrite (life) liabilities located in France without requiring the authorisation of the ACPR[13]. With Brexit, the United Kingdom will become a non-EU country, consequently it will lose the benefits of this liberal regime.

If they infringed the prohibition to operate in France, British insurers would be subject to a criminal sanction for illegal exercise of insurance in accordance with Article L. 310-27 of the Insurance Code[14]. Furthermore, insurance intermediaries incorporated in France which would offer the contracts of these insurers, would also be subject to a possible criminal sanction[15].

In addition, UK entities will no longer be subject to the prudential requirements of Solvency 2 Directive, as the United Kingdom may eventually adopt different rules.

There would, therefore, exist a difficulty with regard to the ability for the *Autorité de contrôle prudentiel et de résolution* ("***ACPR***") to ensure, on the basis of Article L. 612-2 III of the French Monetary and Financial Code[16], that UK insurers post-Brexit insurers comply with the provisions which would remain applicable to them (including Book I of the Insurance Code on insurance contracts), to the extent that they will no longer exercise their activities under a European passport.

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[12] On these two liberties applied to insurance undertakings, see Comm. CE, 2000/C43/03, 2 February 2000, Commission Interpretative Communication, Freedom to provide services and the general good in the insurance sector.

[13] On the criteria for location of risk or commitment: Dir. 2009/138/EC, Article 13 (13) and (14).

[14] Insurance Code, Art. L. 310-27: "Should one of the transactions referred to in paragraphs 1, 2 and 3 of Article L310-1 be underwritten in France in violation of the provisions of Articles L310-2 and L310-6, such act shall be punished by a three year prison sentence and a fine of EUR 75,000."

[15] Insurance Code, Art. L. 524-2: "Submitting for subscription or having contracts on behalf of an undertaking subject to the supervision of the Autorité de contrôle prudentiel et de résolution, of another undertaking referred to in Article L. 310-2 or of an undertaking referred to in Article L. 310-1-1 and not entitled to carry out the corresponding operations in the territory of the French Republic shall be punishable by a fine of EUR 3 000.
In the event of a recurrence, a six-month prison sentence may also be imposed.
The fine provided for in this Article shall be given for each of the contracts offered or subscribed, without the total fines incurred exceeding EUR 6 000."

[16] Mon. Fin. Code – Art. L.612-2 III.: "The Autorité de Contrôle Prudentiel has responsibility for monitoring compliance by the entities referred to in paragraphs I and II operating in France under freedom to provide services or freedom of establishment with the provisions applicable to them, taking account of the supervision carried out by the competent authorities of the Member State in which their registered office is located which have sole responsibility, inter alia, for overseeing their financial situation, operating conditions and solvency, as well as their ability to meet the commitments they have assumed in respect of their insured parties, members, beneficiaries and reinsured companies."

1.2 - Remedial solutions

Becoming nationals of a third country post-Brexit, insurers in the United Kingdom will consider various solutions to continue their business in France.

The main solutions identified are the following: transfer of business to a subsidiary authorised in the EU (1.2.1), the establishment of a third country branch (1.2.2), the use of a European company (1.2.3).

1.2.1 - The transfer of business to an EU authorised subsidiary

Before Brexit enters into force, UK insurers have the possibility to transfer their portfolios of contracts to an authorised and controlled EU subsidiary from which they can operate in France.

In this respect, Article L. 310-2 I. (1) of the Insurance Code provides that direct insurance operations may be carried out in France by "*undertakings that have their registered offices in France, from their registered office or branches lawfully established in a Member State of the European Union*".

The UK insurer can therefore create a subsidiary in France, if it does not have one already, to which it will transfer its portfolio of contracts to the extent that it will be duly licensed by the ACPR[17]. It is important to note that the transfer of a portfolio from the United Kingdom is subject to the UK procedures, known as Part VII[18], which prove to be particularly long. Indeed, these procedures fall within the jurisdiction, not of *the Prudential Regulation Authority* ("***PRA***"), but of the Courts of the United Kingdom and, in application of Article 39 of Solvency 2 Directive, involve consulting with the authorities of the relevant countries.

In practice, there are several possible options.

In the case of a transfer of a portfolio including risks located in France to an insurer located in an EU country other than France, the ACPR must be consulted. This authority must initiate the procedures provided for in Articles L. 364-1 and L. 364-2 of the Insurance Code. The ACPR shall notify policyholders *via* a publication in the Official Journal, examine the risk of transfer to verify that the interests of policyholders are well preserved (no contractual changes in the context of the transfer, in particular), and verify that the transferee has the necessary authorisations/approvals (freedom to provide services or freedom of establishment in France, etc.). The ACPR is required to deliver an opinion to the PRA within three months.

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[17] *Dir. 2009/138/EC, Article 176.*

[18] *Financial Services and Markets Act 2000 (FSMA), Part VII Control of Business Transfers, Section 105.*

In the case of a transfer to an entity which registered office is located in France to be authorised by an English judge, the PRA notifies the ACPR that a solvency certificate is required by the English judge to authorise such transfer[19]. Indeed, according to Article 39 of Solvency 2 Directive: "*Such transfer shall be authorised only if the supervisory authorities of the home Member State of the accepting undertaking (i.e. here the ACPR) certify that after taking the transfer into account the accepting undertaking possesses the necessary eligible own funds to cover the Solvency Capital Requirement.*"

The ACPR therefore has to carry out various checks on whether or not it can provide such a solvency certificate, which will formally demonstrate the financial strength of the transferee. To this end, the ACPR based its decision on (i) the information provided by the UK authority[20] and (ii) the analysis of the pre and post-transfer situation. If the ACPR does not issue the certificate, the transfer cannot be approved.

Finally, it should be noted that any insurance subsidiary located in another EU Member State may operate in France under the regime of freedom of establishment or freedom to provide services. Article L. 310-2 I. (2) of the Insurance Code provides that direct insurance operations may be carried out in France by "*foreign undertakings having their registered offices in a Member State of the European Union, from their registered offices or branches lawfully established in another EU Member State*".

1.2.2 - Establishment of a third country branch

Article L. 310-2 I. (4) of the Insurance Code provides that insurance operations may be carried out in France by "*foreign undertakings other than those referred to in paragraphs 2 and 3 above [i.e. non-European undertakings and life insurance undertakings of Swiss Confederation], from their branches lawfully established in France.*"

Article L. 329-1 of the same Code states that such third country undertakings may only carry on their business after obtaining the administrative authorisation for their branch and the special authorisation for their general agent. It also provides for the possibility for the ACPR to constrain such undertakings to provide a deposit or other guarantees, if their home country has taken or taken similar measures vis-à-vis French undertakings.

[19] FSMA, Part VII, Section 111. In order to authorise the transfer, the English judge must have the certificates provided in Schedule 12, Part 1: Certificates as to margin of solvency (always necessary), Certificates as to long-term business (necessary under conditions), Certificates as to general business (necessary under conditions), Certificates as to and as to consent (necessary under conditions).

[20] See Decision on the collaboration of the insurance supervisory authorities, EIOPA-BoS -17/014, 30 January 2017, Article 4.2 and s.

The establishment of a third country branch is, therefore, constraining and does not confer the right to the European passport. This procedure is not quite used in France: only two branches are currently operating under this regime. Therefore, this option appears to be less suited to British insurers wishing to continue their activity in France after Brexit, especially since it could only be implemented after the effective date of withdrawal of the United Kingdom.

Instead, it could be adapted to European entities wishing to exercise in the United Kingdom. The UK supervisory authority published on 28 March 2018 a *Supervisory statement* in which it sets out its vision at this stage of the supervisory equivalence regime and the criteria under which it will invite for the establishment of a subsidiary rather than a third country branch (particularly if the amount of liabilities protected by the UK Guarantee Fund exceeds GBP 200 million)[21].

1.2.3 - Recourse to a European company

The European company status should be envisaged. Such status would involve a change in the insurer's status in the United Kingdom and then its relocation to a EU Member State along with its portfolio without the latter being subject to a transfer procedure[22].

Indeed, one of the assets of this social form is that the European company does not relate to the Member State in which it has its registered office. It can freely transfer that head office within the EU without changing its nationality or being dissolved. A UK insurer could then consider establishing a European company (necessarily before Brexit) and transfer its registered office in the EU. This solution is also envisaged by EIOPA in its "*opinion on services continuity in insurance in light of the withdrawal of the United Kingdom from the European Union*" published on 21 December 2017.

If the transfer of the head office implies the transfer of the portfolio of contracts (without any approval procedure needed), it will however be necessary, at least in France, to go through a (lightened) authorisation process of the European company. However, as the European company and its portfolio are relocated in the EU, it will be necessary to transfer the portion of this portfolio corresponding to UK activity to the United Kingdom. If such transfer is effected from the EU to the United Kingdom, a formal transfer of portfolio or the establishment of a third country branch would therefore be required after the establishment of the European company, unless more favourable provisions are provided in the United Kingdom[23].

[21] Supervisory Statement | SS2/18 International insurers: the Prudential Regulation Authority's approach to branch authorisation and supervision March 2018.

[22] See Regulation (EC) No 2157/2001 and Directive 2001/86/EC of 8 October 2001. Adde C. com., art. L. 229-1 and s.

[23] The UK Treasury published a statement at the end of 2017 indicating that the United Kingdom would legislate to allow EU institutions operating in the United Kingdom to continue operating in a transitional period ("temporary permission regime"), without needing to establish a specific structure during this period.

Apart from this caveat and the complexity inherent to the creation of a European company, this option offers undeniable advantages to mitigate the loss of the European passport by UK insurers. However, this solution needs to be implemented before the effective exit of the United Kingdom from the European Union.

1.3 - The impact of outsourcing

An entity established in the EU by a UK insurer will be able to outsource certain of its activities or functions to the UK, including the most critical or important ones.

Thus, if the conditions for such outsourcing theoretically guarantee that it is carried out under the supervision of the European supervisor (1.3.1), there is still a risk that such outsourcing would deprive of substance the European entity to the benefit of the UK insurer and that such outsourcing rules are applied in a heterogeneous manner within the Union (1.3.2.).

1.3.1 - Outsourcing conditions

With the Solvency 2 Directive supplemented by the European Regulation of 10 October 2014 (Article 274), a burdensome framework provides for the outsourcing of functions or activities by the undertaking. This outsourcing means any "*agreement, in whatever form, between an undertaking and a service provider, whether or not subject to control, under which the service provider executes, either directly or by using itself the outsourcing, a process, a service or an activity, which would otherwise be performed by the undertaking itself*»[24].

The scope of outsourcing is, however, difficult to circumvent, notably when it comes to the determination of services conferred to outsourcers by insurers. Indeed, if the services covered by the insurance distribution are in principle excluded from this scope to be governed by their own rules[25], other services, critical or important, may be included, such as underwriting, asset management and claims settlement.

When characterised, outsourcing cannot relieve the insurer of its obligations towards both its customers and regulators[26]. This is why it must be subject to a written policy approved by the

[24] Insurance Code, Art. L. 310-3 13 °.

[25] With Order No. 2018-361 of 16 May 2018 transposing Directive (EU) 2016/97 of 20 January 2016 on the distribution of insurance, it is defined as "the activity of providing recommendations on insurance or reinsurance contracts to submit, propose or assist in the conclusion of such contracts or to carry out further preparatory work for their conclusion, or to contribute to their management and enforcement, in particular in the event of disasters" (C. ass. art L. 511-1 I.).

[26] Insurance Code, Art. L. 354-3, para.1.

Board of Directors or the Supervisory Board. This policy, which is periodically reviewed and adapted, notably describes the selection processes of service providers, details to be included in the outsourcing agreement and the undertaking's contingency plans. It also takes into account the impact of outsourcing on the institution's activity as well as the reporting and monitoring arrangements to be implemented[27]. For the purpose of this monitoring, the insurance undertaking must ensure that the provider cooperates with the ACPR and provides access to the business data or outsourced function [28]. Finally, outsourcing needs to be reflected in the Own Risk and Solvency Assessment (ORSA), described in the Solvency and Financial Condition Report (SFCR) and justified in the regular report to the supervisor (RSR)[29].

When functions are deemed to be "*important or critical*", the measures relating to their outsourcing are significantly strengthened. These functions include key functions (actuarial, risk management, compliance verification and internal audit) as well as functions which interruption could have a significant impact on the business of the undertaking, its ability to effectively manage risks or challenge the conditions of its authorisation in respect of various elements[30].

When the insurer plans to outsource one of these services, it is required to inform the ACPR by providing it with a file describing and justifying the operation. In substance, this outsourcing is possible only if it does not jeopardise the insurer's governance, if it does not unduly increase its operational risk, if it does not hinder ACPR's supervision, and if it does not undermine the level of service offered to policyholders.

Under those conditions, the insurer is required to verify that the relevant provider has the necessary skills and authorisations to perform the functions assigned to it, and that no conflict of interests with the insurer jeopardises such exercise[31]. Furthermore, when the service provider belongs to the same group as the insurance undertaking, the latter shall assess the extent of the control it exercises on it or the influence it may have on its actions[32]. Finally, when outsourcing involves a key function, the

[27] Dir. 2009/138/EC, Article 41, Article 41; Reg. Delegate (EU) 2015/35, 10 Oct. 2014, Article 274, 1. ; Insurance Code, art. L. 354-1, para. 3.

[28] Directive 2009/138/EC, Article 38, 1; Insurance Code, art. L. 354-3.

[29] Delegated Reg. (EU) 2015/35, 10 Oct. 2014, Articles 294 and 308.

[30] Insurance Code, art. R. 354-7. The elements of the assessment are:
- the cost of outsourced activity;
- the financial, operational and reputation impact of the undertaking on the failure of the service provider to perform his performance within the time limits;
- the difficulty of finding another provider or returning to live business;
- the undertaking's ability to meet regulatory requirements in case of problems with the provider;
- potential losses for policyholders, subscribers or beneficiaries or reinsured undertakings in the event of a failure of the provider.

[31] Delegated Reg. (EU) 2015/35, 10 Oct. 2014, Article 274, 3.

[32] See EIOPA, Guidelines on the system of governance, 2013, East. No 46, 1.85.

insurer is required to assess the reputation and experience to perform this function, of the employees of the service provider or the service sub-provider[33]. Since outsourcing does not relieve the insurer from its obligations, it has to designate a key function manager who is able to submit to a critical review the services and performance of the provider.

In any event, outsourcing shall be subject to a written agreement between the provider and the insurer, the content of which is specifically detailed by regulation[34].

1.3.2 - The risk of immoderate outsourcing

Compliance with the scheme described above should address the risk that an entity established in the EU by a UK insurer, would be deprived of real substance while its decision-making and operational centre would remain in the United Kingdom, outside of the effective control of the European supervisor. In this respect, EIOPA has recently issued an opinion on Brexit, in which it recommends strict vigilance among European supervisors on the outsourcing of important and critical functions, in particular to third countries[35].

However, the Haut Comité expresses concern that some Member States are more flexible than others in applying the outsourcing rules and thereby, will not incentivise UK insurers to transfer their European business under their jurisdiction.

Anyway, the European framework resulting from Solvency 2 Directive seems to impose sufficiently important constraints on the outsourcing of operational functions or activities. Its effectiveness should therefore be ensured. Engaging at the European level a reflexion about setting uniform requirements for outsourcing of important or critical functions may be welcome. The opportunity of introducing appropriate supervision under the aegis of EIOPA for the implementation of the supervisory framework by national competent authorities, should also be discussed. Indeed, beyond outsourcing, the risk of *forum shopping* largely depends on the thoroughness with which each Member State applies and controls all regulatory rules to which its insurers are subject (licensing conditions, system of governance, etc.).

It should be noted that the application of the General Data Protection Regulation ("**GDPR**") is likely to mitigate the risk of general outsourcing[36]. Indeed, this Regulation lays down a principle of

[33] *EIOPA, Guidance on the System of Governance, 2013, East. No 14, 1.35.*

[34] *Delegated Reg. (EU) 2015/35, 10 Oct. 2014, Article 274, 4.*

[35] *See EIOPA, Opinion on supervisory convergence in light of the United Kingdom on 11 July 2017.*

[36] *Reg (EU) 2016/679, 27 April 2016. Adde L. 2018-493 of 20 June 2018 on the protection of personal data (amending Law No 78-17 of 6 January 1978).*

prohibition of the transfer of personal data to third countries, a principle which can only be waived by virtue of an adequacy decision or appropriate guarantee[37]. Thus, outsourcing post-Brexit to the United Kingdom activities requiring a large transfer of data, such as contract underwriting or claims management, is likely to be subject, in the absence of equivalence with the United Kingdom, to this prohibition, given that the GDPR is extraterritorial unlike standard regimes of authorisation[38].

Recommendations

In light of the above, the HCJP considers that, in the interest of policyholders, it is appropriate to facilitate the creation of European companies and subsidiaries in France.

To that end, the HCJP recommends to simplify the authorisation procedure taking into account:
- the extremely tight timeline, which requires procedures to be accelerated;
- the current equivalence of authorisation conditions between France and the United Kingdom;
- the need to enhance the attractiveness of Paris financial centre.

The ACPR has already introduced accelerated and simplified authorisation procedures in the context of Brexit to welcome UK institutions[39]. In particular, with regard to the recovery of existing activities and already supervised by the competent authority of the home country, the authorisation procedure may rely on existing documents in English, such as those which have already been submitted to the UK authorities or those that concern the branch whose activity would be taken over by the subsidiary or the European company. Applicant entities will be assigned an English-speaking file officer who will steer the procedure and will be able to provide all necessary advice and information prior to the submission of the authorisation file.

This simplified procedure does not, however, mean that authorisations will be granted automatically. In addition, in order to prevent the relevant European companies or subsidiaries from being deprived from any substance, the effectiveness of their governance, the extent of internal reinsurance to the group and their outsourcing policy should be subject to special review[40]. A discussion at the European level on whether to limit the outsourcing of important or critical functions by reserving it to EU-established providers should be undertaken. It is also desirable that the ability of the European authorities (ESAs, here EIOPA) to ensure the effective and consistent implementation of European rules by national supervisors be strengthened.

[37] *Reg (EU) 2016/679, 27 April 2016, Article 44 and s.*

[38] *Reg (EU) 2016/679, 27 April 2016, Article 3.*

[39] *See Joint Communiqué ACPR-AMF of 26 September 2016: https://acpr.banque-france.fr/sites/default/files/medias/documents/20160928-cp-acpr-amf-agrements-brexit.pdf.*

[40] *See EIOPA, Opinion on supervisory convergence in light of the United Kingdom posted from European Union, BoS -17/141, 11 July 2017.*

II - Brexit's impact on the continuity of insurance contracts

It is not disputed that, at Brexit's date, the underwriting by UK insurers of new insurance policies in France will be prohibited (2.1), the continuity of outstanding contracts on the same date raised further questions (2.2).

2.1 - Future contracts

When Brexit will be effective, a British insurance undertaking will no longer be able to underwrite insurance contracts by which it would cover risks located in France (2.1.1). With a view to continue outstanding contracts, this prohibition should also be extended to other contractual operations or events (2.1.2).

2.1.1 - Prohibited underwriting

When Brexit will be effective, the underwrtiting of contracts with UK insurers, covering risks or commitments towards policyholders located in France, will be prohibited and be subject to various sanctions: on the one hand, the conviction of such insurers for illegal exercise of insurance activity (see above 1. A.), on the other hand, the invalidity of such contracts in accordance with Article L. 310-2 III of the Insurance Code[41], it being precised that such invalidity would not be opposed to policyholders acting in good faith.

British insurers will therefore only be able to enter into new contracts in accordance with one of the remedial solutions discussed above (*see above 1. 1*), in particular by creating a European company or a subsidiary authorised in France or in any other EU Member State, from which they will operate in France under the regime of freedom of establishment and/or and freedom to provide services.

2.1.2 - The extended prohibition

In addition to the mere underwriting of contracts (*i.e.* their conclusion), the prohibition should affect any new commitment made by the insurer while performing outstanding contracts on Brexit, which would at least exclude the renewal at maturity of annual or multi-year contracts, the deferment of the extinctive term (including tacit renewal) and the addition of new collateral[42].

[41] *Insurance Code, art. L. 310-2 III: "Contracts subscribed in breach of this Article shall be void. However, such nullity shall not be valid if it is in good faith to the policyholders, subscribers and beneficiaries."*

[42] *In any event, the prohibition would aim at outstanding Brexit contracts, which implies that their validity was not impaired by the latter (on this question: see below). In this respect, contracts subject to the Evin Act, tacitly renewable annually, but not cancellable by the insurer, would be treated as outstanding contracts.*

The HCJP considers that this prohibition includes any contract modifications increasing the value of the initial commitments and, more broadly, any contractual changes that would increase the insurer's liabilities. In order to differentiate the prohibited changes from those permitted, reference could also be made to their impact on the premium: the only possible changes would result in a repayment or reduction of the latter. Rather than a general criterion, the permitted changes could also be expressly identified, such as termination, pledge by amendment of the policy, designation or change of beneficiary, redemption or reduction in life insurance. European and national authorities should decide on the scope of the authorised contractual changes.

2.2 - Outstanding contracts

The *Haut Comité* intends to recall that, in the interest of policyholders, it is important that contracts outstanding on Brexit date can be performed until their term in accordance with the commitments initially undertaken by the contracting parties. These contracts are validly constituted (2.2.1).

2.2.1 - Validity of outstanding contracts

Contracts that have been regularly entered into with a UK insurance undertaking before Brexit must not see their execution challenged once Brexit has taken its effect. Indeed, Article L. 310-2 III of the Insurance Code deems invalid only those contracts that are "underwritten" without the insurer having the necessary authorisation.

In its above opinion "*on services continuity in insurance in light of the affected of the United Kingdom from the European Union*", EIOPA reached the same conclusion: "*Insurance contracts concluded before the Withdrawal date by UK insurance undertakings in the EU27 and by EU27 insurance undertakings in the UK by way of freedom of establishment and freedom to provide services are in principle valid after that date.*"[43]

As a result, these insurance contracts outstanding on Brexit date being validly concluded, they shall continue and be performed in accordance with the willingness of the parties, notwithstanding the loss of the passport.

However, the work of the HCJP revealed the following issue: would the loss of the European passport deprive British insurers of their ability to continue the provision of services resulting from the execution of these contracts?

[43] *Opinion on service continuity in insurance in light of the withdrawal of the United Kingdom from the European Union (section 2.5), 21 déc. 2017.*

In its Opinion of December 2017, EIOPA considers that, failing to take all necessary measures before the date of withdrawal of the United Kingdom of the European Union to ensure the continuity of their insurance services under outstanding contracts (service continuity), UK insurers should no longer be able to perform their contracts.[44]

In its Notice of 8 February 2018[45], the Commission recalled the British insurers that they had to, as the loss of passport could prevent them from keeping performing the contracts entered into before Brexit, take all necessary measures to allow the continuity of performance of their contracts.

Thus, according to these opinions, British insurers could automatically be struck by a prohibition on the execution of their insurance services resulting from outstanding contracts, such a prohibition being criminally sanctioned in France.

The aim of the European Authorities position seems to promote a swift transition and to reduce the scope of uncertainty surrounding outstanding contracts, until national judges have decided on the issue (paragraph 2.7 of the Opinion).

Moreover, the recent French reform adding the lapse of contracts (*caducité*) to the Civil Code (Article 1186 C. civ[46]) introduces an additional doubt on the effects of a change in regulatory framework which could deprive the UK insurer of its ability to manage outstanding contracts. Subject to the Courts' discretion, this framework could be qualified as an "essential element" of the insurance contract and the disappearance of such element could result in the lapse of such contract. The abovementioned Article L. 310-2 III could be interpreted as edicting the authorization to operate as a condition of validity which shall be satisfied on the date the contract is underwritten (otherwise the contract shall be invalid) and shall not disappear thereafter (otherwise, the contract shall lapse).

However, under the terms of the regime instituted by the reform of contract law, it should be required that authorisation to operate in France be qualified as "essential element" of the insurance contract since Article 1186 of the Civil Code provides: "A valid contract lapses if one of its essential elements disappears." As a whole, the members of the working group believe that this condition would not be

[44] *Opinion on business continuity in insurance in light of the United Kingdom from the European Union (Section 2.6), 21 Dec. 2017.*

[45] *European Commission: Notice to stakeholders withdrawal of the United Kingdom and EU rules in the field of insurance/ reinsurance, 8 February 2018. "According to the Solvency II Directive firms are required to take measures to ensure that contracts can continue to be serviced.*
To this end, firms shall assess the impact of the affected of the United Kingdom from the European Union on their operation and contract portfolios and, in cooperation with the national succession supervisors, identify and mitigate risks (see Article 41(4) and 46(2) of Solvency II Directive. See the EIOPA Opinion of 21 December 2017 on the service continuity in insurance in light of the alienation of the United Kingdom from the European Union)."

[46] *Article 1186 of the Civil Code: "A validly formed contract becomes obsolete if one of its essential elements disappears."*

[47] *Civil Code, Articles 1186 and 1187. However, the unenforceability provided for in Article L.310 -2 of the Insurance Code for the nullity of contracts would not, in the current state of the text, apply to their lapsing.*

met and more generally consider Brexit would not justify in itself the invalidity or lapse of outstanding contracts.

However, as emphasised by EIOPA and the European Commission, it will be up to the national jurisdictions[48] to decide, according to applicable law, the impact of the change brought by Brexit in the legal environment on the continuity of contracts. It will also be up to them to judge the possible liability of insurers under Solvency 2 Directive to take all reasonable steps to ensure continuity and regularity in their operations.

Some contributors have proposed to limit the scope of Article L. 310-2 III of the Insurance Code by redrafting it. The purpose of this text would be to prohibit any contract underwriting, but also any (limitedly defined) change in existing contracts, and would have allowed *a contrario* interpretation that unmodified contracts could be executed freely. However, the HCJP is not in favour of any such modification.

2.2.2 - Is the management of outstanding contracts an insurance business?

The question arises as to whether contract management is an insurance activity subject to criminal sanction[49].

There were debates among the HCJP working group members on this question: it is either an insurance activity which may be subject to the same requirements as the underwriting of new business, or it is an activity which is carved out from the monopoly of insurance, so that insurers could continue to do so after Brexit.

(1) A first analysis observes that, under French law, Article L. 310-1 of the Insurance Code, to which Article L .310 -27 refers, does not restrict insurance activity solely to the underwriting of contracts covering insurable risks, but tends more generally to cover risks (reference is made indifferently to liabilities for life insurance[50] and to cover risks in respect of non-life insurance). Thus, claims management would fall into the definition of risk coverage.

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[48] Note that English law is generally applicable to contracts that cover large exposures and the law of the risk situation for most others (Rome Regulation, Article 7).

[49] Criminal liability by Insurance Code, art. L. 310-27— Only on the basis of the criminal liability of UK insurers, the majority of contributors to this report considered that the execution of validly underwritten contracts should not give rise to criminal proceedings, in particular due to the absence of an intentional element.

[50] Insurance Code, art. L.310-1: "The State shall exercise control in the interest of insured, policyholders and beneficiaries of insurance and capitalisation contracts. Said control concerns:
1° undertakings which, in the form of direct insurance, contract obligations whose performance depends on human longevity, undertake to pay capital in the event of marriage or the birth of children or invite investment by the public with a view to capitalisation and contract specific obligations for said purpose;
2° undertakings which, in the form of direct insurance, cover the risks of bodily injury related to accidents and illness;
3° undertakings which, in the form of direct insurance, cover other risks including those related to an assistance activity."

However, some participants in the group considered that the purely exegetical interpretation of Article L .310 -1 seemed fragile. The text distinguishes insurance contracts from their subject matter:

- on the one hand life insurance and capitalization in respect of "*liabilities incurred*",
- on the other hand insurance on "body damages" and "other risks" with respect to "*cover*" the latter.

The interpretation referred to in (1) could thus lead to the conclusion that extinctive management of outstanding contracts would not face any impediments in the field of life insurance and capitalisation, while non-authorised undertakings covering non-life risks would be prohibited, which interpretation would be asymmetric.

(2) However, since the entry into force of Solvency 2 Directive, insurance undertakings that cease to underwrite new contracts and only manage their existing portfolio for the purpose of ending their business (*i.e.* extinguishing the current business of the outstanding contracts) remain subject to Title I [General rules on the taking-up and pursuit of direct insurance and reinsurance activities], II [Specific provisions for insurance and reinsurance] and III [Supervision of insurance and reinsurance undertakings in a group] of that Directive[51].

Thus, the management of outstanding contracts by UK insurers would be assimilated to extinguishing portfolio management.

Control over operations which would consist in keeping performing outstanding contracts for the sole purpose of extinguishing those contracts may be justified as a result of a possible modification of prudential rules applicable to UK insurer post-Brexit, which would fall outside the control of the supervisory authorities.

The competence of the ACPR post Brexit to ensure compliance by UK entities with the provisions applicable to them[52] (including Book I of the Insurance Code) could indeed be challenged, without the competence of the PRA being established with respect to the protection of European policyholders.

The absence of ACPR's power of control over these entities comes along with the risk of a change in prudential rules by the UK authorities with respect to outstanding contracts. This risk appears to be a tangible risk for long-risk contracts (*e.g.* some life insurance contracts, some civil liability insurance contracts and non-cancellable contracts on the initiative of the insurer…). On the contrary, continuation of contracts whose effects come to an end at maturity (often annual) does not seem to be affected by such a risk.

[51] However, transitional measures are provided for in this Directive and have been transposed into Article 26 (non-codified) of Ordinance No. 2015-378 of 2 April 2015 (which transposes the article 308 b of Dir. 2009/138/EC). These measures shall apply until 1 January 2019 to insurance entities which are in the phase of extinguishing management as at 1 January 2016 and meet a number of conditions. As a result, these firms, which only manage their existing portfolios, remain subject to the ACPR supervision and all requirements under Titles I, II and III, including the licensing requirements.

[52] Competence based on Article L. 612-2 III of the French Monetary and Financial Code.

Finally, on the extension of extinctive management regime to outstanding contracts, it was also noted that according to the Luxembourg CAA, "*the payment of claims before the date of withdrawal*" would constitute a "*transaction not dependent on the European passport*". The "*coverage*" of risks not yet occurred would only be covered by the "*coverage*" of risks that arose before Brexit and are being settled. This position may be difficult to hold when taking into account the practical difficulties in defining "*claims*" to be "*paid*". Indeed, it can take many years before the "*payment*" has to be executed. For example, this is the case where the contract covers "*composite risks*" which partially occurred (with respect to the liability insurance, if the victim's "*claim*" has not yet been formulated) or where a dispute is between the underwriter and the insurer about the guarantee due by the insurer (when the insurer contends that the damage which indemnification is sought is caused by a gross negligence of the policyholder). However, in order to make these payments, insurers have had to keep in the meantime the control and management of the funds they will use.

(3) The European Authorities, in their Opinions and Alert, argue that UK insurers subject to Solvency 2 Directive to the date of Brexit, will have been informed sufficiently in time of the risk linked to change in the regulatory framework resulting from the loss of the European passport and that they were, consequently, responsible for taking "*reasonable steps to ensure the continuity and regularity in the performance of their activities, including the development of contingency plans*"[53]. It is noted that EIOPA has established a cooperation platform for the national competent authorities of the Member States to exchange information and facilitate cooperation on Brexit issues. It is therefore up to the competent national authorities to ensure that insurance undertakings preparedness to the impacts of Brexit, in particular in terms of preparing and implementing contingency plans after the effective withdrawal of the United Kingdom from the EU. However, European Supervisory Authorities do not have the power to force the relevant insurers to transfer their portfolios. In the event of a "hard" Brexit, UK authorities might be reluctant to require insurers subject to their authority, to transfer to the EU all assets on which their liabilities are backed.

Furthermore, it is possible that a British insurer, despite its efforts, may not find a registered transferee to take over its portfolios, even if the undertakings involved (which are often dependent on groups specialised in the extinctive management of outstanding contracts), may also establish subsidiaries within the EU in order to manage these portfolios.

[53] *Article 41 (4) of Solvency 2 Directive.*

2.2.3 - Extending the regime of extinctive management of contracts

In order to reduce the legal uncertainty supported by the doubt introduced by the European Authorities' positions, the HCJP proposes that the loss of the European passport of UK insurers operating in France should be treated by analogy with the lapse of authorisation of French insurers. As a reminder, the lapse of the contract is recognised by the ACPR in particular when the insurer "*expressly renounces to one or several authorisations by committing itself to no longer underwrite new contracts*". As a result, the insurer is subject to "*the supervision of the ACPR until all liabilities arising out of contracts subscribed by the undertaking have been fully and definitively paid to the policyholders and third parties or that the entire portfolio of contracts has been transferred under the conditions provided in Article L. 324-1*[54]". Under this framework, the insurer is required to submit a liquidation program to be approved by the ACPR specifying in particular "*the foreseeable time limits and financial conditions for liquidation, as well as the resources and equipment used for the management of residual liabilities*"[55]. If the Authority considers that the program does not comply with the interests of the policyholders, it shall not approve it and may request the submission of a new proposal within the time and conditions it requires. In the absence of a program or in the event of non-compliance with the approved program, it can also use its administrative and disciplinary powers. Furthermore, the impediment to the ACPR's prerogatives related to the implementation of this framework can be criminally sanctioned[56].

The establishment of a regime comparable to this framework to deal with outstanding contracts would present the advantage of neutralising the risks of the lapse of contracts and sanctions mentioned above, while allowing the control of the ACPR over the performance of outstanding contracts. Doubts have nevertheless been raised about the real power of the ACPR to control an entity which, administratively and prudentially, would remain subject to British law and to the British regulator. Moreover, the proposed solution faces the difficult identification of the moment from which liquidated contracts will be deemed to be definitively and fully settled.

Subject to its precise wording and the conditions under which cooperation between the French and British authorities would allow for effectiveness, the *Haut Comité* considers that the proposed arrangement is of significant interest in dealing with the consequences of Brexit on outstanding contracts. Beyond Brexit, this regime would offer an appropriate framework any time an insurer loses its European passport because of its Home State decision to exit the EU.

[54] *Insurance Code, art. L.321-10-3.*
[55] *Insurance Code, art. R. 321-22.*
[56] *Insurance Code. L. 310-28.*

Recommendations

The HCJP considers necessary to promote, or even to ensure, in the interest of policyholders, the performance of outstanding contracts on Brexit's day until their maturity. In this respect, there are two alternatives.

The **first** would be based on the establishment and combination of:
- a transitional period, which may extend to 31 December 2020, to enable the transfer of the relevant portfolios concerned, the creation of a European Company or third country branch, and
- an acquired right permitting the management and liquidation by UK insurers of outstanding portfolios that would occur within 5 years from the end of the transitional period.

For portfolios of contracts whose liquidation is not possible within this period of up to 5 years (*e.g.* medical liability insurance or construction), UK insurers will have to regularize their situation during the transitional period by transferring these portfolios to a subsidiary in the EU, creating a European Company or a third country branch.

It would of course be preferable for this transitional regime to be part of a political agreement with the United Kingdom, providing for reciprocity of the regimes. As a result, a European framework will also have to be established to check the application of this agreement by UK firms.

Finally, in the residual situations where UK insurers would not have regularized their situation notwithstanding the transitional period and the acquired right, the relevant policyholders concerned could, however, claim the performance of their contracts if they were validly subscribed before Brexit.

The second, recommended by the *Haut Comité*, would be to introduce in the Insurance Code a scheme specifically dealing with the loss of the European passport by insurers operating in France under this regime and which Home State would have decided to withdraw from the EU/EEA. This regime would require a procedure comparable to the one governing the lapse of authorisations as set out in Articles L. 321-10-2 and 3 and R .321 -22 of the Insurance Code.

This new procedure would provide that the relevant insurers submit to the ACPR a voluntary liquidation plan of their portfolios involving operations carried out in France. Failure to comply with this obligation, in addition to disciplinary sanctions and administrative measures to which it may give rise, may also be criminally sanctioned, if necessary, for the breach of the ACPR's prerogatives which, with respect to the execution of an approved plan, would have a supervisory power until the complete and final execution of the liquidated contracts.
However, discussions with the United Kingdom will have to be initiated in order to ensure, in a cooperative framework, the effectiveness of such supervision.

COMPOSITION OF THE WORKING GROUP

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CHAIRMAN :

- **Dominique Borde,** Partner, Cabinet Paul Hasting

RAPPORTEUR :

- **Pierre-Grégoire Marly,** Professor of Law, University of Le Mans

PARTICIPANTS :

- **Bénédicte Denis,** Partner, Cabinet Norton Rose Fullbright
- **Carine Delfrayssi,** Paris Europlace
- **Gérard Gardella,** Secretary General of the HCJP
- **Richard Ghueldre,** Partner, Cabinet Gide Loyrette Nouel
- **Pauline Joly,** HCJP
- **Gilles Kolifrath,** Partner, Kramer Levin Cabinet
- **Bernard Mettetal,** Partner, HMN Cabinet
- **Nicolas Magnier,** AXA France
- **Marietta Osiander,** Scor
- **Olivier Perraut,** Scor
- **Aline Poncelet,** Partner, Cabinet Paul Hasting
- **François Rosier,** French Federation of Insurance
- **Maud Schnunt,** Covéa
- **Aurore Zagury,** BNP Paribas

TREASURY REPRESENTATIVES

- **Geoffroy Cailloux**
- **Aymeric Pontvianne**
- **Sébastien Raspiller**
- **Clément Roman**

REPRESENTATIVES OF THE ACPR

- **Hélène Arveillers**
- **Benjamin Besnier**
- **Gwenola Trottin**