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Brexit 2019 risks & opportunities for insurance firms

Jan 2019

Agenda

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2. Regulatory context
   Alex Barnes, Partner, Moore Stephens
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   Tom Barford, Associate Director, Moore Stephens

Thoughts from the industry

Peter Staddon, Managing Director, MGAA

Regulatory context

Alex Barnes, Partner, Moore Stephens

The ‘B’ word … or Brexit

Current position

On 29 March 2019, the UK will leave the EU

Soft Brexit

Implementation period (within Withdrawal Agreement)

- set to start on 29 March 2019 and last until 31 December 2020 - EU law and consumer rights and protections will continue to apply in the UK
- During this time, firms will continue to have access to the same passporting arrangements as they do now
- Will come to a close before the end of December 2020

Hard Brexit

Withdrawal Agreement needs to be approved by the UK Parliament and the European Parliament in order to take effect on exit day. If not, hard Brexit

EU insurers – UK business

- Ongoing business – Temporary permissions regime (TPR)
  - Temporary permissions regime (TPR) will enable EEA firms to continue their activities in the UK for a limited period after Brexit
  - Businesses can now apply for TPR

- Run-off – Financial Services Contract Regime (FSCR)
  - Ensures firms can fulfil existing contractual obligations in the UK for a limited period of time, even if they are outside the TPR, following the UK's withdrawal from the EU - i.e. run-off existing UK contracts and to conduct an orderly exit from the UK market. Maximum 15 years for insurance contracts, 5 years for other financial services

- What EU insurers and brokers need to do
  - Can apply TPR or FSCR initially, then set up company or branch in UK

UK insurers – EU business

- Ongoing business
  - No EU provisions, so need to set up branch of company in EU
- Run-off – some limited legislation being drafted
  - France and Germany drafted legislation to allow existing contracts to be run-off
  - No EU-wide legislation proposals even though some have been drafted for derivative contracts (insurance seems to be off the radar)
- What UK insurers and brokers need to do
  - Insurers and brokers need to establish an EU Company or branches in each EU location

How the market is reacting

- Insurers
  - Underwriters have or are setting up companies in the EU
  - Some fronting arrangements have been established (e.g. Lloyds)
  - Some reconsideration of which jurisdiction was first selected

- Brokers/ coverholders / intermediaries
  - Medium and smaller intermediaries tend to be behind the risk carriers
  - More differences in regulatory frameworks for intermediaries, so beware!
  - A number of intermediaries are choosing branches over companies

Question

What stage of the restructuring process is your firm at?

1) No restructuring required
2) Target jurisdiction identified
3) EEA/UK entity created
4) EEA/UK entity authorised
5) Transfer of business completed

Operations & legal entities

James Eldridge, Director, Moore Stephens

Operations & legal entities

What restructuring is likely to be required?

- EEA authorised branch(es) or subsidiary for current outbound passports
- UK authorised branch or subsidiary for inbound passport
- Temporary permissions?
- Access to Lloyd’s?

Is there enough time left?

Operations & legal entities

How would you implement the restructuring?

- Create or acquire new authorised entity or branch ✓
- Substance ?
- Business transfer ✓
- European Cross-Border Merger X
- Societas Europaea X
- Part VII transfer ✓
- Partner – fronting ?
- Exit from UK/EEA? ?

Operations & legal entities

What are the operational issues?

- Legal framework
- Regulation
- Capital
- Taxation
- People

Question

How confident are you that the market participants your business works with are prepared for Brexit?

1) I am very confident
2) I am confident
3) I am mildly concerned
4) I am very concerned
5) I don't know

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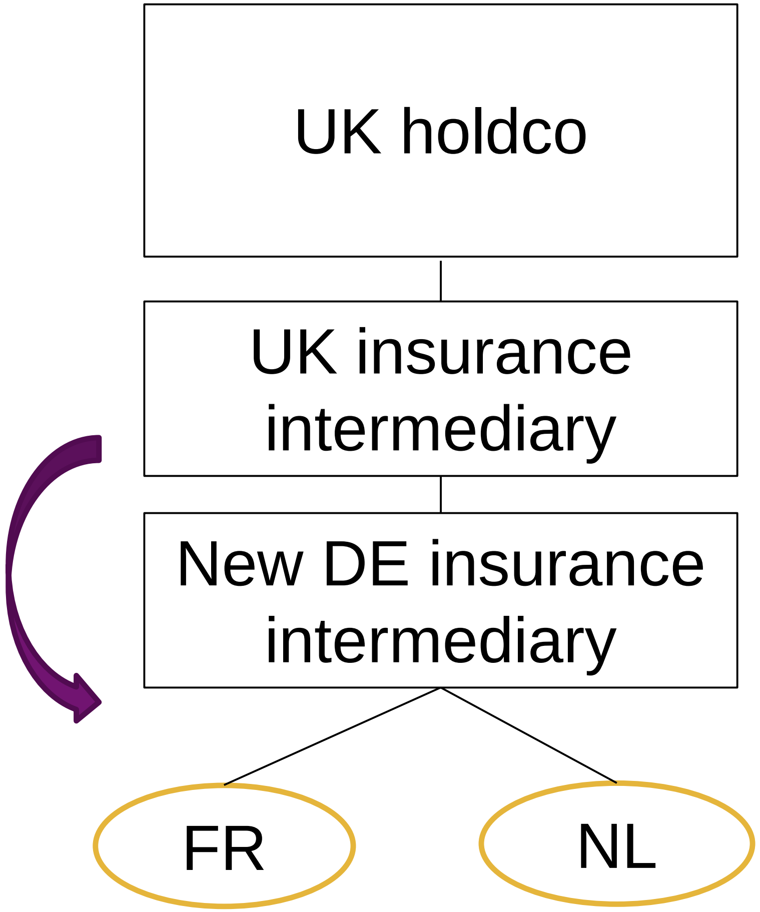
Tax: beware of the traps

Thomas To, Director, Moore Stephens

Brexit tax considerations

Proposed structure



Transfer

Tax issues:

- Jurisdiction
- Equity/debt funding
- Transfer of trade and assets – capital gains and transfer taxes
- **Global mobility**
- **VAT**
- **Transfer pricing**
- Withholding taxes
- Exit planning

Brexit issues - VAT

- Charges from UK to EU subsidiary
  - Potentially exempt from UK – no VAT recovery
  - If back-office only - reverse charge in receiving country, as not exempt?
  - If broking/placing business, possibly exempt under Andersen CJEU case (depends on individual country’s position)
- Charges from EU to UK
  - Taxable out of the EU, exempt into UK (no reverse charge)
- Transfer of business cross-border, Part VII or otherwise
  - Will this qualify as a Transfer of a Going Concern (TOGC)?
  - If not, what is the valuation in case of reverse charge?

Brexit issues – transfer pricing

- Setting up EU subsidiary or a branch
  - Compliance issues whichever country is chosen
  - Potential target countries have similar rules but some local variations
  - Some countries have flagged that stricter transfer pricing rules will be introduced in 2019/2020 e.g. Ireland
  - Documentation will need to be revised including master file, local files and country by country reporting (if applicable)
  - Potential impact on effective tax rates depending on the country chosen and also the type of transaction e.g. back office type or brokering
  - General environment is one of greater transparency and substance is key

Brexit issues – UK PAYE & NIC implications

If an employee remains working in the UK

- No changes after Brexit; straightforward scenario
- Employee will remain subject to PAYE & NIC in the UK
- UK tax legislation and Double Taxation Conventions will remain in force
- The UK's exit from the European Union will not change existing double taxation arrangements. Double taxation agreements ensure that anyone (not just a British citizen) who is living in a country that has a treaty with the UK will not pay tax in two countries on the same income/gain and determines which country has primary taxing rights
- The UK has a double taxation agreement with all EU countries, which will continue to apply after we leave the EU

Brexit issues – UK PAYE & NIC implications

If an employee transferred to another EEA state

- Employee transferred from the UK to be employed and solely work in another EEA member state
- No longer UK resident or performing duties in the UK
- No tax or NIC on remuneration in the UK
- Complete and submit form P85 to HMRC on departure
- Employee will be subject to income tax and social security legislation in state where duties are being performed

Brexit issues – UK PAYE & NIC implications

If an employee will work in another EEA state and the UK

- Consider where employee is tax resident and who employs him
- Potentially subject to PAYE and withholding tax in both jurisdictions
- Consider PAYE relaxation – net of foreign tax credit (Appendix 5) where employee will remain UK tax resident and employed
- If employed overseas then ‘host UK employer’ should consider whether a Short Term Business Visitors Agreement is appropriate for the relaxation of UK PAYE
- Consider EU social security rules on multi-state workers if employee will regularly work in two or more member states to determine where employee is subject to social security contributions

Brexit issues – social security implications

- Basic provision of EU law is that an individual will normally be subject to the contribution rules of only one member state – **generally the state in which they physically work**
- Their employer is also liable to social security contributions in that state, even where the employer may be located in a different EEA member state.
- Exceptions to the above rule:
  - Where an employee has been temporarily transferred on secondment from an existing role in one member state to work in another EEA member state.
  - EU regulations allow for such individuals to remain insured under the home country scheme for up to 5 years where certain circumstances are met
  - Multi state workers:
  - Liable in country they reside if they perform 25% or more of their activities in that country

Brexit issues – social security implications

- Transitional arrangements have been agreed whereby the existing EU rules will remain in place for employees whose assignments commence prior to 1 January 2021
- EU rules will apply to these individuals “for as long as they continue without interruption to be on assignment, commuting or travelling between the EU and the UK”
- This should mean that they remain subject to EU legislation on contributions and benefits for the remainder of their assignment periods beyond 1 January 2021
- Situation not so clear for movements/assignments commencing from 1 January 2021
- Will very much depend on outcome of Brexit agreement

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M&A outlook post-Brexit

Tom Barford, Associate Director, Moore Stephens

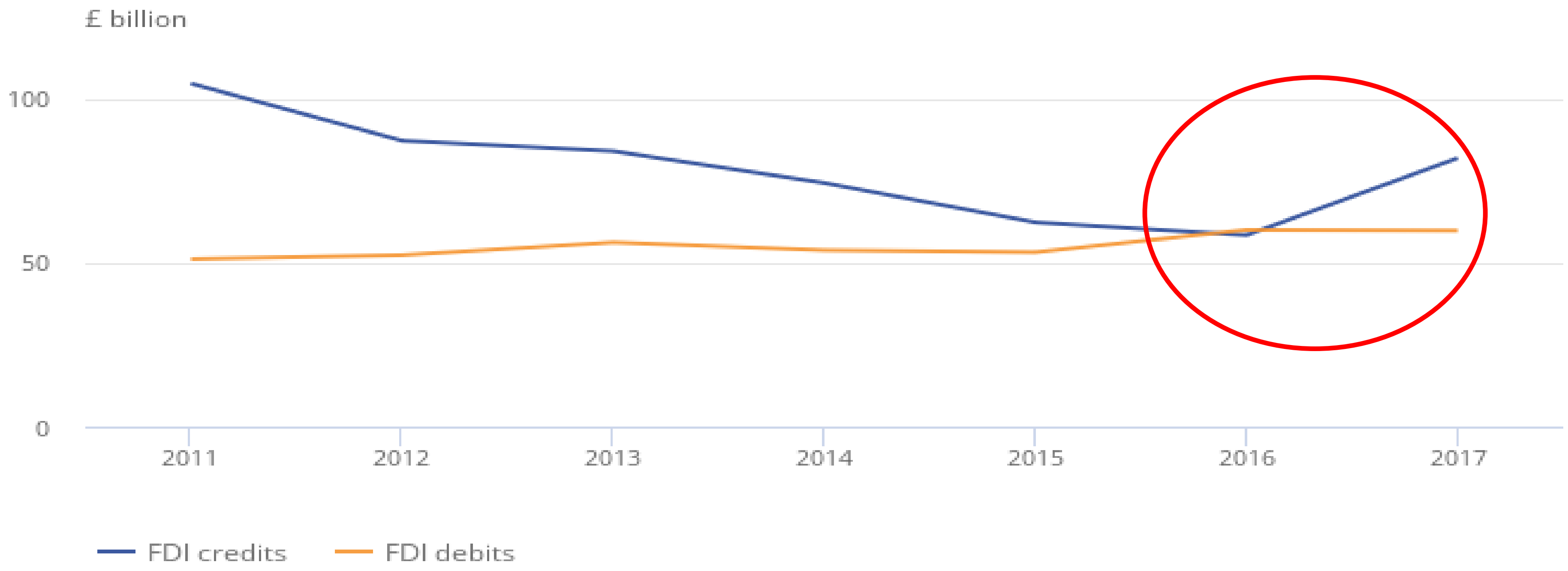
Brexit – impact so far

Sterling's slide against the dollar

Source: Financial Times

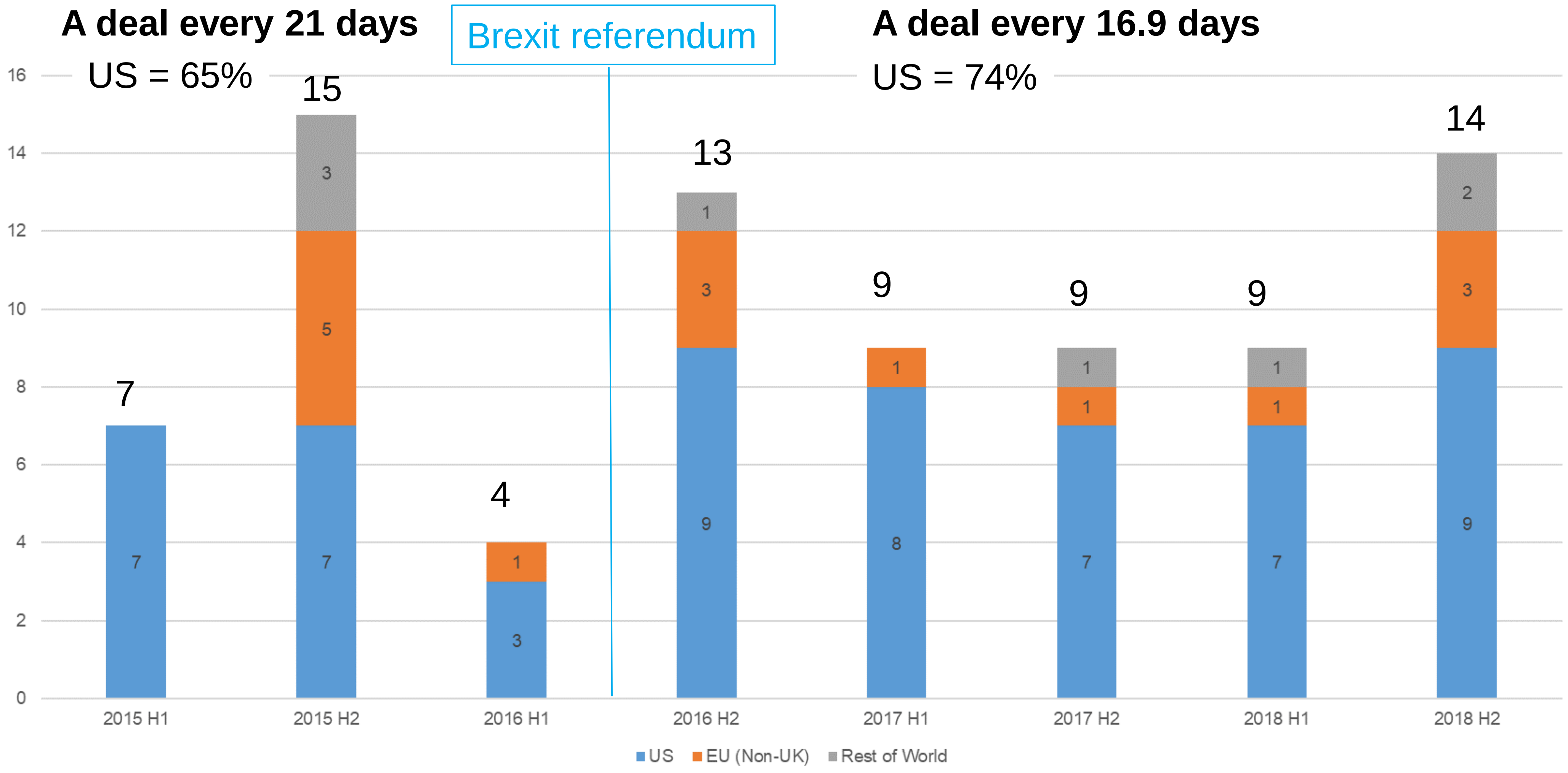
Brexit – impact so far

Foreign direct investment – 2011-2017



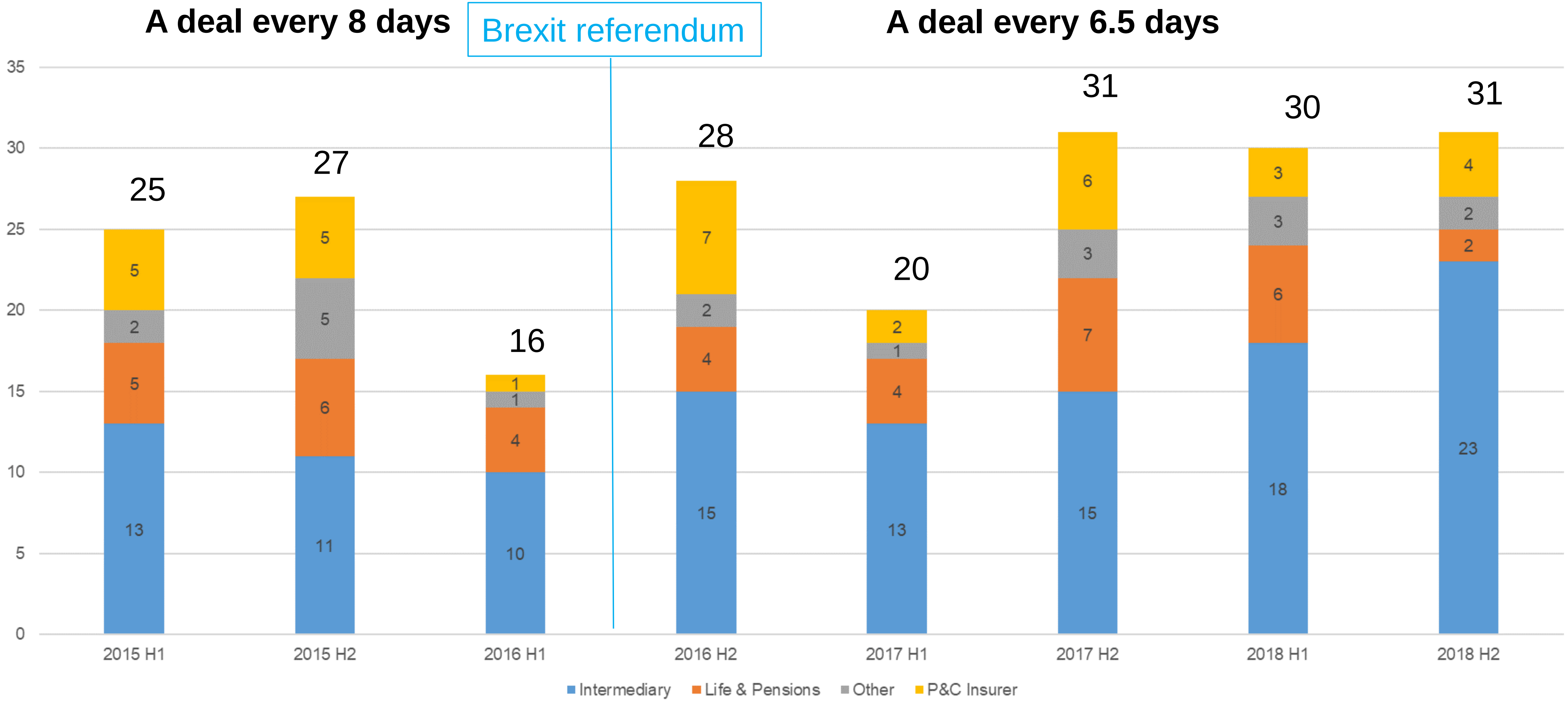
Source: Office of National Statistics

Brexit – impact so far



Source: Mergermarket data

Brexit – impact so far



Source: Mergermarket data

Brexit – impact so far

- Increase in foreign direct investment in insurance M&A (US driven)

- Sustained levels of insurance M&A
  - There are non-FX factors
  - Brexit may have accelerated deals in 2018 due to upcoming period of heightened uncertainty

Short-term Brexit implications

1. Impact on specific insurance businesses
   - Impact will be uneven
   - Restructuring likely to be possible
   - Business will become more costly and less efficient
2. The macro impact on the insurance industry
   - Higher degree of uncertainty – timing and nature of Brexit
   - High risk of political and financial uncertainty – potential recession
   - Negative impacts: lower attractiveness of doing business and flight of capital

Brexit in context

There are a number of factors impacting the insurance market at the start of 2019:

- "Decile-10" – Lloyd's performance management
- Impact of technology on the value chain
- Continued period of consolidation in the intermediary market
- Factors driving M&A activity unchanged

Conclusions

- There may be a short term M&A slow down
- The impact and duration depends on what sort of Brexit we have
- Brexit could provide incentives for M&A
  - There may be opportunistic exits in areas where multiples are higher
  - Private equity exits and short term deal making
  - Strategic divestments could be expected in areas most impacted
  - Technology, innovation and cost efficiency likely to be key drivers of M&A activity
  - Scale reinforced as a key factor in M&A

Question

To what extent has Brexit impacted your M&A plans so far?

1) Significantly (high)
2) Somewhat (medium)
3) Minimally (low)
4) Not at all
5) Not applicable / Don’t know

Questions or comments?