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VIEWPOINT

UK regulators may be unable to cope with Brexit pressures

Already overburdened by Solvency II, the pressure on regulators will mount to unprecedented levels in 2017

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This year is one in which the insurance industry will have to face many challenges. Many of these are well known and obvious; adequacy of rates and the dangers of climate change; the advent of insurtech and the role of alternative capital are well documented. One of the greater threats has, however, crept up on the industry silently, but will manifest itself over the coming year.

The regulators in the UK – the Prudential Regulation Authority (PRA) and the Financial Conduct Authority (FCA) – have been very busy over the past few years. The implementation of Solvency II has stretched the resources of the PRA in particular, at a time when the need for good and experienced compliance officers in the industry has created competition for resources.

The PRA provides a regulatory service which is an international gold standard. It is known for its scrupulous implementation and enforcement of regulation. It does not cut corners. This high standard reflects well on the companies it regulates and creates a competitive advantage for them.

Maintaining such high standards when faced with the burden of work Solvency II has created is difficult and the consequence has been that the PRA cannot be as responsive as the industry would like. It takes around three years for a new insurance company to be approved. Indeed, only a handful of new insurers have been authorised in the UK in recent years. There has been a backlog in approval of Part VII transfers.

And now in 2017, the pressure on the PRA and the FCA is about to mount to levels that cannot have been contemplated.

It is difficult to see how the PRA, struggling already under the burden of Solvency II, can possibly hope to cope with the weight of work that will soon be foisted upon it by Brexit

The PRA regulate 700 insurance companies. There are also some 500 EU and European Economic Area (EEA) insurers which are passported into the UK through the single market. The EU referendum result has thrown a cloud of uncertainty over those companies operating under passporting arrangements. Until negotiations are under way, and probably complete, we shall not know what the position of companies operating under passporting rights will be. Those companies must plan for the future and plans take time to implement. They cannot wait until April 2019 to decide what to do. They must begin to act in 2017.

Lloyd's has already announced it will be taking steps to establish a subsidiary within the EU. Other companies must do the same.

And here lies the problem. The 500 EU/EEA companies operating in the UK must look at their own positions. Some are Gibraltar-authorised and should be able to continue as before. Others will want to establish UK subsidiaries and Part VII transfer their existing books of UK business to them. Still others will want to withdraw from the UK but will need to make provision for the run-off of UK business. This could entail transferring the portfolio to a run-off provider. Others may have existing UK authorised entities and simply seek to transfer the business to them. Finally, some may seek to bypass the PRA and set up operations in Gibraltar.

Prudential Regulation Authority: Solvency II has already put pressure on the UK's regulator, which now faces further complications as a result of the Brexit vote

This means 500 companies (less a few regulated in Gibraltar) will need to take steps that will require intense scrutiny from the PRA.

Passporting

At the same time, many of the 700 UK-authorised companies are operating in the EU through passporting rights. They will need to determine how to deal with their EU operations. This could be by establishing a subsidiary and transferring the business into it. Again, this will require some involvement from their regulator, the PRA.

Much of the restructuring work that needs to be done, will require statutory portfolio transfers such as those under Part VII. These are only available between EU/EEA companies. Once the UK leaves the single market, transfers will not be able to be made from the UK to the EU or the EU to the UK. There is, therefore, as legislation stands at present, time pressure on companies to reorganise themselves before the two year notice period from the giving of notice under Article 50 expires.

Each company has an obligation to prepare itself for the impact of Brexit. The timescales and ongoing uncertainty means no company can wait to see what might happen. The messages emerging from the UK government and from the UK are varied, conflicting and confusing. They do not add to any sense of certainty. Hope that the UK might remain in the single market is not sufficient to enable delay or complacency. Plans must be drawn up and steps taken to implement them during the coming year.

To be frank, it is very difficult to see how the PRA, struggling already under the burden of Solvency II, can possibly hope to cope with the weight of work that will soon be foisted upon it.

Obviously, one solution would be to remain in the single market and to announce this soon. Another would be to announce transitory measures to allow a longer timescale to implement the necessary changes and yet, at the same time, ensure all business is properly regulated and policyholders are protected.

Such announcements cannot, however, be made until they are negotiated and negotiations are likely to take a long time. Until then, the insurance industry must take steps to protect themselves, their business and the policyholders. Whether the regulators are capable of helping them to achieve this remains to be seen.

The next 12 months could be a most worrying year. ■

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