Brexit — the next steps?

Briefing pack for the Insurance sector

27 June 2016

Leaving and negotiating process

Leaving process

- **Leave vote:** Leave 51.9%, Remain 48.1% - following a referendum on 23 June 2016, Britain voted to Leave the EU
- **No legal precedent:** There is no legal precedent for a country the size of the UK to leave the EU – however Article 50 of the Lisbon treaty provides for the process of a Member State wishing to leave the EU
- **Article 50:** Article 50 allows a two year timeframe for the exit to be negotiated once the European Council has been notified of the country's wish to exit
- **Timing:** There is no time limit on when the country must give notice on the intention to leave – therefore the leaving process could extend beyond the two years (and the two year timeframe could be extended if *all* EU countries agree to this)
- **New Prime Minister:** David Cameron has resigned and will be standing down before the start of October. He has said that it will be up to the next Prime Minister to decide when to trigger Article 50

Negotiating process

- **Leverage:** Waiting allows the UK to stabilise politically – but unclear how the EU will react as it is keen to begin negotiations with the UK immediately – holding off triggering Article 50 could be seen as leverage for negotiations
- **New Prime Minister:** The next Prime Minister will be selected by the Conservative Party (the governing party of the UK) – the candidates are voted on by Conservative MPs until two remain who go to a vote by the wider party membership
- **No parliamentary majority for Brexit:** Only c.150 MPs across all political parties in the UK support Brexit – this is short of a 314 majority required to pass a law – as a result a "Brexit Bill" may not be able to get through Parliament
- **Early General Election:** The failure of a "Brexit Bill" could lead to a loss of confidence in the Government, which then could trigger an early General Election
- **Opposition:** The Labour Party (Britain's main opposition party) have tabled a vote of no confidence in their leader – the likely outcome of this is currently unclear
- **Negotiating options:** Overall the negotiating process remains uncertain – there are four broad options for a future relationship with the EU outlined on the next page

Options for future relationship with the EU

There is no certainty about what Britain's relationship with the EU will look like. Article 50 does not provide any clarity on this and there is no precedent. A settlement which benefits the UK and the EU would need to be reached and below are the four broad categories this might fit into:

The Norway Option

Membership of EEA

- Participation in the EU internal market but no access to EU Free Trade Agreements ("FTAs")
- Member of European Free Trade Association (EFTA)
- Free movement of goods, services, people and capital

The Switzerland Option

Membership of EFTA but not EEA

- Participate in EFTA free trade agreements
- Negotiate a bilateral trade agreement with the EU
- Not part of EU VAT area

The Turkey Option

Customs Union

- Customs union with the (EU like Turkey)
- No customs are levied on goods travelling within the union
- A common external tariff is levied on all goods entering the union

The WTO Option

Trade under WTO MFN tariffs

UK leaves both EU and EEA and:

- Membership of WTO without any specific agreement with the EU
- Only option to free UK of all obligations of the EU

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Brexit timeline and process

UK completely removed from EU membership – assuming exit triggered shortly after referendum

Businesses should evaluate what risks and/or opportunities Brexit would present for them and prepare accordingly

Leave vote June 2016

2016 | **2017** | **2018**

Defining the terms of the UK exit

Determining the nature of the UK's relationship with the EU

Immediate impacts

Economic uncertainty may be felt immediately following a vote to leave the EU and persist while the precise terms of exit are thrashed out

Implementation of changes

Each EU regulated sector would face different regulatory conditions

Companies benefiting from EU agreements would see an impact on the conditions applying to their access to the single market

Uncertainty over exit strategy

Article 50 and the two year time window are only triggered when the UK government notifies the EU, this could be delayed until after a leave agreement has been negotiated – potentially stretching out market uncertainty over two years

What will change?

The EU's Four Fundamental freedoms: Free movement of

People	Services	Capital	Goods
The freedom to live and work across the EU	The freedom to provide cross-border services	No restrictions on the movement of capital	Free movement of goods without internal frontiers or tariffs

The impact on any group will depend on both the extent to which it benefits from the Four Freedoms and how these will be affected by Brexit. This latter point is not simple to answer and it is currently very unclear what form the UK's new relationship with the EU will take.

In a financial services context, the most significant implications are likely to be in relation to services, capital and people.

The following pages summarise some of the key regulatory, legal, tax, employment and economic impacts that need to be considered when assessing the impact of Brexit.

Implications of exit – the Four Freedoms

Loss of the free movement of services and freedom of establishment

A UK firm would no longer be able to 'passport' across the remaining EU countries and an EU firm may not be able to 'passport' into the UK. New licences would need to be negotiated or new business structures adopted. The UK makes significant net exports of financial services to the rest of the EU and there is a risk that business could simply move elsewhere.

Loss of the free movement of capital

Without the ability to move capital freely across borders, financial institutions may decide to relocate to a base inside the Eurozone although free movement of capital into and out of the EU (as freedom of capital applies more broadly than intra-EU) as a whole will continue to benefit the UK. However, capital could still be affected regardless of the negotiation and the inflow of capital needed to finance the UK's huge current account deficit could also dry up, leading potentially to currency devaluation, higher inflation and increased interest rates.

Loss of the free movement of persons

Brexit will end the automatic right to freedom of movement to and from the UK. This will impact on UK nationals living and working in other EU countries and nationals of other EU member states living and working in the UK. It could restrict UK businesses' access to talent and cause disruption to their existing employees.

Secondary implications

These will likely include possible exchange rate fluctuations (and impact on hedging strategies), impact on credit ratings (both the UK's own and those derived from it) and resultant increase in borrowing cost etc., equity and bond market volatility, access to Euro clearing services, ability of regulators to deal with all the change, a second Scottish referendum, etc.   Some of these have already been seen in the days leading up to the vote and the immediate aftermath.

Areas of focus 1

Passporting

Will passporting still exist and what form will it take?

How much business do you write in Europe?

Do you have a “natural hedge” (e.g. another EU carrier)?

Will operations need to be moved to another jurisdiction to satisfy new regulatory requirements?

Immigration

Will people be able to stay in the UK or move freely?

How much of a factor is this in current recruitment strategy?

When and how will you communicate with these staff about any changes?

Technology

What are the group’s core technology requirements?

Where is this based?

Will this need to change and what are the implications of needing to change it?

Should a contingency plan be put in place?

Business and operating model

Will you be able to continue with your current model?

What additional capital might be needed?

What will the regulator ask you?

Will you still be able to access all your customers?

Investment portfolio

How vulnerable are your investments to interest rate and credit spread movements?

How will FX movements and market volatility affect you?

What impact will such movements have on your capital?

The insurance sector needs to carefully consider the impact of the vote to leave. We are seeing different approaches being taken across the industry, broadly though there are ten areas to focus thinking on. Not all of these are relevant to every group however consideration should be given to the implications of each.

Areas of focus 2

Privacy & Data

How will the institution deal with data protection?

How will you handle cross border data transfers in future?

Impact on customers

Will any of your significant customers will be hit hard by the vote to leave?

Which of your lines of business will be particularly affected?

Can you still write global or EU-wide programmes?

Legal

Will legal contracts and policies need to be amended/ re-papered?

Which core agreements will be impacted?

What is the impact on cross-border business units?

How would the institution manage a vast legislative change?

Macro factors

If the UK's sovereign debt is downgraded how will this affect you?

What will be the effects of exchange rate changes?

Could there be import led inflation post leaving?

What will be the short term effects on the economy?

Other

Do you need to communicate with the market and rating agencies?

What corporate governance changes will need to be made post leave?

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Overview of the insurance regulatory issues

Global and national regulators have created a complex regulatory environment changing the business model of insurers, brokers and other financial services firms. Brexit means that UK financial services groups would no longer be required to conform with EU regulation and this slide offers some perspective on how groups should consider the below themes.

Legal structures

— Not possible to predict how cross border legal structures would change after Brexit. The conditions of these legal structures could determine the location of non-EU institutions within Europe and the location of markets and opportunities in the future if the ability to passport through the UK is no longer available to third countries.

— If, as a result of Brexit, clearing or settling the Euro is no longer possible in the UK, the UK may lose its reputation as an international financial hub.

Euro market changes

— The resilience of the UK market will depend on how well it is able to adapt to the risk of markets such as the FX market potentially gradually moving to Europe.

Trading conditions with the EU

— The volume of outgoing trade with the EU could change following Brexit. There is also a risk of tariffs on imports and exports with EU, which could impact business customers of insurers.

— The UK may be unable to influence initiatives affecting UK financial institutions wishing to do business in the EU.

Meeting global regulatory standards

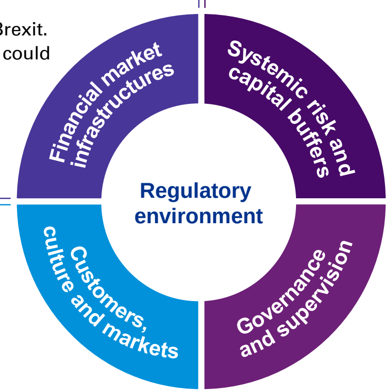
— Broadly speaking, regulation governing financial stability in the UK originates from Global Standards of the G20 and the FSB. The impact of Brexit on financial stability regulations in the event of a Brexit is likely to be low.

Stricter approaches to prudential regulation

— From a capital perspective, there would be greater focus on the PRA to set capital requirements.

Tougher UK regulations could not be challenged by EU

— Country specific rules or national reforms already in place would not change following Brexit.



Divergence in approach to corporate governance

— Corporate governance across the EU has not been as strongly implemented as in the UK and would therefore be unlikely to be subject to change following Brexit. Over time there may be some divergence over how UK and EU clients are treated.

Trading conditions of customers

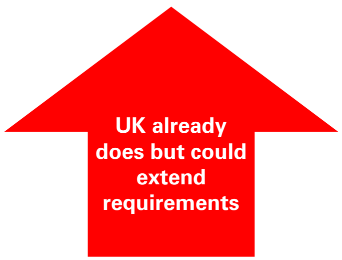
— There is a risk of tariffs on imports and exports with the EU, which could impact business customers of insurers. This could affect the health of wider economy, the wider market.

PRA/FCA tougher stance than in EU

— It is unlikely that capital requirements would be a concern for UK insurers if the UK were to leave the EU, given the strict requirements of the PRA.

Impact of Brexit on significant insurance regulations

The UK has on many occasions been a driver for change within the area of European insurance regulation, with Solvency II influenced by the UK individual capital adequacy regime and EIOPA adopting some of the FCA's initiatives within its conduct framework, for example its proposed guidelines on product oversight and governance, its report on mobile phone insurance and its opinion on payment protection insurance. This anecdotally suggests that Brexit will not have a significant impact on the underlying legislation and supervisory approach, although the loss of passporting rights in particular would have a significant business impact.



- Risk based supervision
- Supervisory colleges
- Senior Insurance Managers Regime (SIMR)
- Corporate governance
- SCR add-ons could be used to address a wider range of issues than Solvency II permits
- Possibility of reintroducing a form of pillar 2 capital add-on

- Solvency II
- Pre-sales disclosure (PRIIPs KID and IDD PID)
- Motor insurance directives
- Product oversight and governance
- Financial sector compensation scheme
- Financial conglomerates
- Anti money laundering (AML) and anti bribery and corruption (ABC)
- Lloyd's Market regulation
- Recovery and resolution planning (but in line with IAIS, not EU, timeline)
- Other market initiatives, such as derivatives (EMIR), Central Securities Depositories regulation (CSDR), Credit Rating Agencies and Markets Abuse Regime

- Increase powers of European Supervisory Authorities
- Financial transaction tax (FTT)

See Appendix 1 for further analysis.

The UK will still need to meet major global standards

The International Association of Insurance Supervisors (IAIS) produces global standards and guidelines which its members need to comply with. These may be on its own initiative to enhance insurance supervision globally or to meet the Financial Stability Board (FSB) requirements, for example in relation to enhanced supervision of global systemically important insurers (G-SII). In order to avoid a negative assessment of compliance by the International Monetary Fund (IMF), the UK would still need to meet these requirements.

	Prudential regulation	Conduct regulation	Financial stability measures	Governance and supervision
Global standards	IAIS — Majority of the Insurance core principles (ICPs) relate to prudential regulation — Common Framework for Internationally Active Insurance Groups, including development of a global insurance capital standard (ICS)	IAIS — ICP 19 (Conduct of Business), ICP 21 (Countering Fraud in Insurance) and ICP 18 (Intermediaries)	IAIS G-SII package — Enhanced supervision — Strategic risk mitigation plan — Enhanced liquidity management — Recovery and resolution plans — Crisis management groups	IAIS — ICP 5 (Suitability of Persons), 7(Corporate Governance) and 8 (Risk Management and Internal Controls) — ICP 3, 23, 25 and 26 relate to group-wide supervision and supervisory cooperation
EU legislation	**Solvency II** + Commission Delegated Regulations + Implementing Regulations + EIOPA guidelines + EIOPA note regarding external audit	**Insurance Distribution Directive (IDD)** + EIOPA product governance and oversight guidelines **Packaged Retail Investment Products (PRIIP)** + Joint Committee draft Regulatory Implementing Standards		**Solvency II Implementing Regulations** + EiOPA guidelines
UK rules	**PRA** — Solvency II implemented in UK — Rulebook for non-Solvency II insurers — Limited UK specific interpretation and guidance — Solvency II reporting audit requirement expected	FCA — Tends to be ahead of EIOPA — Insurance distribution rules already apply to insurers (not just intermediaries) — Retail Distribution Review + Independent advice — Thematic reviews to identify potential consumer detriment — Financial Ombudsman Service	**PRA** — G-SII measures in place for the two UK G-SII — Little guidance regarding Fundamental Rule 8 for other insurers ("must prepare for resolution so, if the need arises, it can be resolved in an orderly manner with a minimum disruption of critical services")	— Approved persons regime — SIMR and individual accountability — Walker review implementation

There could be significant changes for employees and employers ...

Immigration

The impact will depend on the terms of exit and whether the UK reverts to domestic rules. EU nationals who work or study in the UK (or who want to do so) will be affected.

Changes will impact employers in respect of meeting the costs of changes required to enable EEA nationals to remain in the UK and factor in future recruitment plans.

It is not clear what transitional arrangements will be put in place to allow EEA nationals who are already working or residing in the UK to acquire permanent residence rights. It is also not clear what might happen to those who have not resided in the UK for long enough to claim permanent residence status – will they need to leave?

Similar concerns are likely to apply in reverse to any British nationals currently living and working in the EEA.

Well established employment laws are likely to stay

Many UK employment laws were introduced before being mandatory under EU law (e.g. discrimination protection now amalgamated into the Equality Act 2010). Some UK employment rights go further than required by EU law (e.g. family rights such as shared parental leave). Many UK laws which were implemented to comply with EU law are established and well regarded by employers, employees and trade unions (e.g. right to paid holiday). Given the political agenda to improve workforce equality and employment protection, it would be controversial to repeal these on a Brexit.

Some unpopular laws could be revised

Holiday pay – Developments on holiday pay have been unpopular. For example, many employers dislike the ECJ's decisions which allow employees to keep accruing holiday while on sick leave. The recent decisions on holiday pay have increased costs and many employers would prefer not to be bound to pay normal remuneration in line with European principles.

TUPE – The protection afforded to employees under TUPE can be onerous, making it difficult for businesses to harmonise their workforce post transfer. Although the government may not repeal the TUPE legislation entirely, it is likely that it will reduce the red tape for employers and relax provisions so that employers have more flexibility on business transfers and outsourcings.

Agency workers – The Agency Workers Regulations 2010 are also unpopular because they give agency workers similar rights (including pay) to employees from day 1 and after 12 weeks doing the same role. Given that these Regulations are relatively new, it is possible the Government would revoke them.

The automatic right to work in other EU states will no longer apply

Brexit will end the automatic right to freedom of movement to and from the UK. This will impact on UK nationals living and working in other EU countries and nationals of other EU member states living and working in the UK. Brexit could therefore increase the number of individuals who seek citizenship in the UK/other member states to enable them to continue living and working in their preferred member state. Although the Government may try to reduce migration to the UK, it will need to consider whether businesses can function without labour from across the EU. We anticipate some bargaining in this area.

… as well as numerous legal and tax implications

Legal and data issues

Data issues

— Transmission of data (e.g. personal data) across borders would be problematic if the UK is not subject to the same data protection rules as the EU.

Legal issues

— While the restrictions of EU law are seen as a driver for exit, the fact that the ineffective implementation of EU law locally may be relied upon by a citizen (including corporates) but not vice versa will be removed. The ultimate arbiter on all matters of law will be the UK Supreme Court.

— Cross border mergers where one of the states involved requires EU membership for both states could prove difficult.

— It may no longer be possible to transfer insurance portfolios outside the UK as a result of a lack of suitable legal framework.

Contractual considerations

— Following Brexit, there is a possibility that judgements of EU courts would no longer apply and there will be no basis to invoke the benefit arising under EU law against the UK Government.

— Groups would need to revisit all their contracts to ensure that those citing EU law are brought up to date.

Tax considerations

Non-implementation of EU tax directives and initiatives

— EU tax directives that the UK has had to implement would not need to be preserved e.g. mergers directive providing for tax free cross border mergers and parent-subsidiary directive allowing tax free remittance of dividends. State Aid challenges to tax law would also not be available (but withdrawal may allow the UK to introduce regimes which favour particular sectors).

— The EU's recently announced Anti-Tax Avoidance Package may no longer be relevant.

VAT considerations

— EU law and ECJ decisions are the main source of indirect tax legislation. Where UK law and EU law are currently in conflict, the UK law would now prevail (e.g. the UK's broader VAT exemption for insurance intermediary services).

— The exemption for investment management has been the subject of much litigation and Brexit would allow the UK to set the scope of this in a way which maintains the UK's attractiveness as a funds hub. Conversely it would also allow the VAT exemptions around outsourcing to be restricted further than the EU case-law has previously allowed in keeping with HMRC's historic views.. The UK could also take its own approach to VAT on cross-border charges between branches of the same legal entity and consider different place of supply rules to increase the tax take.

Costs associated with structural reorganisation

— There may be tax charges on a range of reorganisational measures resulting from Brexit if it becomes necessary to relocate business as part of wider overall reorganisation. If EU based reliefs are helpful it would be important to effect any restructuring prior to their removal.

— Other costs will also arise such as cost of relocating people, setting up new offices (any new entity will require appropriate substance and suitably skilled local persons to operate it).

Freedom to set own tax rules on transactions

— There would be no requirement to apply rules consistently to UK-UK and UK-EU transactions e.g. UK-UK transfer pricing could be removed.

Global and UK domestic tax developments would remain

— There are a number of OECD tax initiatives which affect multi-national groups (e.g. those under the Base Erosion and Profit Shifting) initiatives. The impact on the UK tax environment of these should remain the same regardless of whether the UK is in the EU.

— Clearly all UK domestic provisions will remain in force.

Customs duties

— Although of less relevance to financial services, in the absence of continuing agreements, the cost of goods imported into the UK and exported by the UK could increase.

Economic impacts and considerations on Brexit

In addition to the capital, regulatory, legal and tax implications, there are wider economic impacts to consider too.

Access to skilled staff

- Workforce
- Working hours
- Immigration
- Pension provisions
- HR processes

Suppliers

- Tariffs
- Exchange rates
- Domestic suppliers
- Intra-group supplies
- Imported materials

How much of your business and customers are based in Europe? Would a Brexit impact access to opportunities?

Business model

- Uncertainty
- Government finances
- Regulations
- Environmental legislation
- Reporting requirements
- Trade agreements

- Cost of capital and amount of capital needed
- Compliance costs
- Products and services provided
- Data governance
- Data collection

How might the regulatory regime change in the insurance industry outside the EU? Would you want it to? How much do you benefit from existing EU agreements?

Markets

- Economic growth
- Impact on insureds
- Market access
- Competition
- Investment
- Investment volatility

- Tariffs
- Regulations
- Taxes
- Domestic business
- Trading
- Intra-group business

How much do you depend on the European market? What about your customers?

Immediate impacts

There is an immediate impact of a leave vote on the UK. This will be felt by the insurance sector and its clients. The outcome will depend on how quickly clarity can be given to uncertainties. Either way the risks of a disorderly exit could cause lasting turmoil in the financial markets.

Exchange rate

The value of Sterling has already fallen, however this may be temporary and there could be a bounce back as happened with Swiss Franc against GBP

Inflation

Lower immigration and weaker FX rates could cause and increase in CPI of 0.5% to 1.5%, this will be driven by wage pressures and the increased price of imports

BoE interest rate

With inflationary pressure and a weak FX rate Bank of England base rates may increase by up to 1% over the medium term

GDP

Uncertainty over the future of the relationship between the UK and EU could depress investment and trade, the net affect could be as much as 0.5% to 1.5% on average lower GDP growth in the first years

Sovereign rating

Lower economic activity and uncertainty over future growth could jeopardise the Government's deficit reduction programme and put pressure on the sovereign debt rating of the UK

Other economic impacts

There are likely to be multiple other impacts including on liquidity, credit spreads, Scotland and inward investment

BREXIT: Understanding your exposure

The potential risks and opportunities posed by the vote to leave must be considered. No two organisations will have the same exposure. Using KPMG's Nine Levers of Value framework below are some of the questions business leaders should be asking to consider the impact on their business of the leave vote.

Financial ambition

- What does the uncertainty mean for availability and cost of capital?
- Will investors continue to fund capital investment programmes?
- How will you update your forecasts?

Markets

- Will business between the UK and EU reduce?
- Will trade with countries with FTAs with the EU be affected?
- Which alternative markets should be explored?

Organisational structure, governance and risk

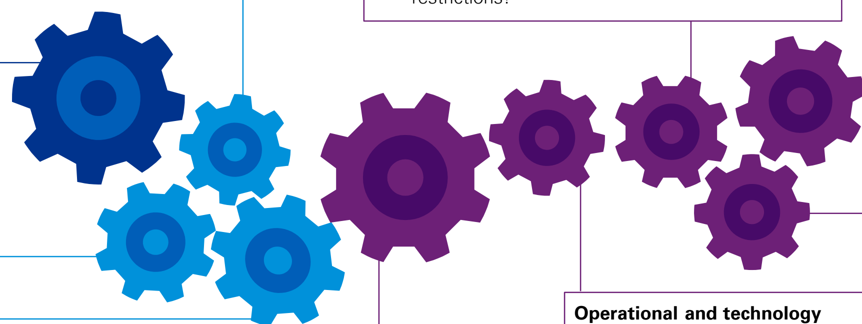
- Will your corporate structure need to change to take advantage of opportunities? Or respond to changes in regulation?
- If you restructure your organisation, will you face tax costs on transition?
- Can you manage your business if you face travel restrictions?

Measures and incentives

- Do you have sufficient data to understand how resilient your business is and the impact of changes on capital requirements?
- How can you improve monitoring to identify any shocks early?
- Have you quantified the potential changes to the effective tax rate?

Propositions and brands

- Will British brands face negative sentiment from EU consumers if discussions become tense?
- What mitigation strategies exist?



People and culture

Reduced freedom of movement could lead to labour shortages.

- How will you meet the gap when non-EU immigration is also restricted?
- How many EU nationals do you employ in the UK? What is the administrative cost of retaining them?
- How will your workforce change? Or your staff culture?
- How will you deal with employment policies after Brexit if UK law diverges from the rest of the EU?

Clients and channels

- UK exporters to the EU will need to consider trade barriers.
- Are your EU customers already developing alternative suppliers?
- How resilient is your business to the loss of key EU markets?
- Will you need to review pricing policy for changes in tax or costs?

Core business processes

- Operations and legal structures will need to be reviewed for unintended consequences.
- Will you need to review your 'go to market' approach?
- Does your distribution footprint and network still make sense in light of the UK leaving the EU?
- Do have enough visibility over your supply chain to identify threats? Do you have natural hedges?

Operational and technology infrastructure

- Will restrictions on cross border activity increase the administration burden on UK firms?
- Will IT systems need to be adapted?
- Are your systems and processes set up for increased logistics, tax impacts or new pricing structures?

Brexit checklist

Ranking the issues	Understanding what outcomes are possible and which are more or less likely is vital to understand the risks. Groups now need to be ready to engage the Government (either directly or through trade or industry bodies) immediately to preserve any regulations or trade arrangements that are important for the group. Those who move first will always play with advantage.
Flexible monitoring	The situation is evolving and keeping up to date with development will be challenging but necessary.
Where are the economic pressure points?	Groups need a clear understanding of their business and supply chain. This is key for understanding the impacts, not just of Brexit, but future volatility in the political-economy. Internal pressure points include operations, work force and financing. External pressure points include suppliers, competitors and customers, both domestic and international.
Where are the regulatory and trade pressure points?	Groups need to have a clear picture of the EU trade agreements and regulations that are crucial to their business, understand how they might change, and comprehend not only the risks but also the opportunities available if those regulations were to change.
Quantify the impacts	Understand what might change under different outcomes. Consider the impact of the vote on the strength of the domestic economy, the costs of trade, financial markets, regulations, the labour force and long term development of the European market.
Prioritise	Rank the severity of the risks and opportunities that the interactions between impacts and pressure points present.
Plan	To the extent that a business can **influence** the outcomes, either through evidence-based contributions to the political debate or through public statement, they should consider the costs and benefits of doing so, including reputational impacts. **Mitigation** strategies need to be developed for negative outcomes that cannot be avoided, but also to take advantage of opportunities which are presented. Finally, where necessary, companies must **adapt** to the new environment in which they operate.

Assess the impact - consider the factors

The following framework is based on our prior experience of risk assessments in the context of the Scottish devolution vote as well as specifically in relation to Brexit. The framework uses two axes to assess the impact Brexit will have on any business. One axis lists the factors that represent a part of the firm’s operating ecosystem that Brexit could potentially affect and these are divided into categories:

— The Four Freedoms of the EU – A fundamental factor in how the Single Market affects the way in which businesses operate, certainly within the EU and the UK

— The raft of laws and regulations that could potentially change, including the terms of trade between the UK and countries outside the EU

— A series of potential direct and indirect economic impacts

The second axis considers the elements of the firm’s operating environment that these changes could affect – supply, demand and competition.

By couching the framework for assessing a Brexit in these terms, we can be sure that any assessment will capture all of the key factors that will determine the firm’s operating outcomes. It also ensures that a holistic view is reached.

Assess the impact - determine the risk areas

		How would the group's ability to supply its markets be affected by a Brexit				How would demand for services be affected by a Brexit				How would the competitive position be affected?		
		The availability and cost of the right labour	**The availability and cost of capital**	**The availability and cost of services**	**Etc.**	**Access to customers in the UK**	**Access to customers in the EU**	**Access to customers outside the EU**	**Etc.**	**Impact on the size of relevant market(s)**	**Impact on main competitors**	**Etc.**
Impact of a Brexit on the Four Freedoms	The free movement of goods			🔴	🟡	🟢	🟡	🔴		🟡	🔴	🟡
	The free movement of services		🟡	🟡	🟡	🟡	🟡	🟡	🟡	🟡	🟢	🟡
	The free movement of people	🟡			🟡	🟡		🟡	🟡	🟡	🟡	🔴
	The free movement of capital		🔴	🟢	🟢	🟢	🟢	🟢	🟢	🟡	🟢	🟢
Impact on laws, regulations, and terms of trade	Changes in the EU/UK laws affecting the business			🔴	🟡	🟢	🟡	🔴		🟡	🔴	🟡
	Changes in the EU/UK regulations affecting the business		🟡	🟡	🟡	🟡	🟡	🟡	🟡	🟡	🟢	🟡
	Changes in taxation in the UK			🔴	🟡	🟢	🟡	🔴		🟡	🔴	🟡
	Changes in taxation in the EU		🟡	🟡	🟡	🟡	🟡	🟡	🟡	🟡	🟢	🟡
	Changes in the terms of trade between UK and non EU states	🟡			🟡	🟡		🟡	🟡	🟡	🟡	🔴
	Changes in taxation on the group outside the EU		🔴	🟢	🟢	🟢	🟢	🟢	🟢	🟡	🟢	🟢
Economic impacts	Exchange rate		🟡	🟡	🟡	🟡	🟡	🟡	🟡	🟡	🟢	🟡
	Interest rates			🔴	🟡	🟢	🟡	🔴		🟡	🔴	🟡
	Economic growth		🟡	🟡	🟡	🟡	🟡	🟡	🟡	🟡	🟢	🟡
	Etc.	🟡			🟡	🟡		🟡	🟡	🟡	🟡	🔴

Appendix 1

Further information on possible regulatory changes

European Legislation: Insurance specific

EU Directives	Commentary	Related regulations and guidelines	UK position post Brexit
Solvency II Directive (2009/138)	On 1 January 2016, Solvency II became effective and 13 existing insurance related directives were repealed. Solvency II and its related regulations and guidelines now provide the entire prudential framework.	— Commission Delegated Regulation 2015/35 — 16 Implementing Technical Standards — 29 EIOPA Guideline papers — EIOPA note on role of external audit	— We expect the UK prudential regulatory regime to continue following Solvency II. — The UK (as a then third country) would need to enter into equivalence decisions to provide comparable treatment to its peers within Europe and prevent loss of trade. — Passporting both into and out of the UK would no longer be possible.
Insurance Distribution Directive (IDD) (2016/97)	The IDD entered into force on 23 February 2016 and will replace the Insurance Mediation Directive (IMD) (2002/92) which will then be repealed on 23 February 2018. Amongst other things, this includes requirements relating to pre-sales product information documents (PID), clarification of home/host member state responsibilities and extends the scope to capture insurers as well as intermediaries.	— EIOPA product oversight and governance guidelines.	— When the IMD was transposed into UK legislation, insurers were included in scope. In addition, several of the requirements were brought in as part of the Retail Distribution Review. We therefore expect the UK to follow these requirements even if outside the EU.
Packaged Retail and Insurance-based Investment Products (PRIIP) (Regulation 1286/2014)	For the insurance sector, the PRIIP Regulations apply only to life savings products. Distribution of other products (life and non-life) is covered by the IDD above. The Regulations will apply from 31 December 2016.	— In November 2015, the Joint Committee of the three European Supervisory Authorities issued a consultation paper on the requirements of the pre-sales Key Information Document (KID). The draft Regulatory Technical Standard (RTS) is expected to be sent to the Commission by 31 March.	— The FCA remains very focused on fair treatment of consumers, including disclosure of helpful information. A recent FCA fine shows that this goes beyond the letter of the rules. — Consistent with this philosophy, we would expect the main principles of PRIIP to be complied with, although a UK exit could see some of the detail in the RTS dropped.
Motor Insurance Directive (MID) (2009/103)	The MID requires all motor vehicles to be covered by compulsory third party insurance and prevents the need for border checks on insurance, allowing free movement of vehicles within the EU. It also sets minimum amounts of compensation levels for both material and physical damage.		— We expect the UK will wish to retain rights to the free movement of vehicles within the EU and the additional protection the MID affords if a policyholder incurs an accident where a European driver is involved.

Related considerations

EU Directives	Commentary	Related regulations and guidelines	UK position post Brexit
Financial Conglomerates Directive (FiCoD) (2002/87)	FiCoD overlays the sectorial specific requirements and applies to groups above a size threshold with significant operations in both the banking/investment and insurance sector. The directive was supplemented by a new RTS in 2014 to provide clarification regarding the conglomerate solvency calculation once CRD IV and Solvency II became effective.	— Commission Delegated Regulation 342/2014.	— We expect the UK prudential regulatory regime to applying financial conglomerate supervision. The UK is the group supervisor to a number of affected groups, both largely insurance and largely banking groups.
Gibraltar	Approximately 25% of the UK's motor insurance policies are written through insurers registered and regulated in Gibraltar. Gibraltar is the only British Overseas Territory that is part of the EU. It is classified as a dependent territory of the UK, so if the UK were to leave the EU, then Gibraltar would be forced to leave as well. Unless special terms could be agreed for it to remain as part of the UK exit.		— Unknown

Appendix 2

Further detail on possible options for the UK post – Brexit

Appendix – Summary of potential scenarios

Process of a Brexit

Article 50 of the Lisbon Treaty created, for the first time, an official path through which members could exit the EU. However this is untested.

Any Member State which wishes to leave must notify the European Council of its intentions. Negotiations will then take place between that Member State and the remaining EU countries through the Council, acting through qualified majority, after obtaining consent from the European Parliament. Once an agreement is negotiated and in force, all remaining treaties will cease to apply to the withdrawing Member State. If negotiations have not been completed within two years, then all Treaties will cease to apply, unless the two year limit is extended by a unanimous vote of Member States.

In the event of an out-vote, Article 50 presents the formal process through which the UK could leave the EU. However, the UK could also simply choose to no longer comply with European legislation. This could lead to the forced withdrawal of the UK from the EU by the other Member States over an unspecified time period.

Potential scenarios in the event of a Brexit

There is no certainty about what Brexit would look like for the UK. Although there are various indications about what might be realistic, there would be a period of uncertainty of up to two years (but could be longer), during which negotiations would take place to determine what form relations would take post withdrawal.

It is not possible to determine the exact form a withdrawal would take and most discussion focuses on five options. It should be noted that EEA membership is not automatic and the UK would first need to apply for membership of EFTA (which it withdrew from on joining the EU).

— UK leaves the EU but remains part of EEA (the 'Norway option');

— UK leaves the EU and EEA, and enters into bilateral agreements around freedom of establishment and freedom to provide services (the 'Switzerland option');

— UK leaves the EU and EEA, and enters into a customs union with the EU (the 'Turkey option');

— UK leaves the EU and EEA, and becomes an independent member of the World Trade Organisation (the 'WTO Option'); and

— UK leaves the EU and EEA, and negotiates a new free-trade area (the 'UK option').

Appendix – Summary of potential scenarios (cont.)

The Norway option

Norway is currently a member of the EEA. As part of the EEA, Norway is a part of the single market and has access to the four freedoms in relation to goods, services, labour and capital. Although trade is tariff free and there are limited non-tariff barriers, as Norway applies harmonised Single Market regulation, there are some additional trade costs as a result of customs controls and rules of origin laws. However, as Norway is not a part of the EU Customs Union, it has greater flexibility to individually negotiate external free trade agreements with other nations outside of the EU.

Norway still pays into the EU budget, although at a reduced rate. In 2011, Norway paid the net equivalent of £106 per capita to the EU budget, compared to the UK's net amount of £128 per capita[1].

Whilst it is subject to EU regulations Norway has no say, operating a so called 'fax diplomacy' with Brussels.

The Switzerland option

Switzerland is a member of European Free Trade Area (EFTA), but not a part of the EEA. As such, its relationship with the EU is governed by around 120 bilateral agreements[2]. Swiss exporters have tariff free access to EU markets through a 1972 Free Trade Agreement (FTA) and a series of bilateral arrangements, principally negotiated in 1999 and 2004. These arrangements also included reduced technical barriers to trade, free movement of labour (including participation in the Schengen zone) and access to the EU's research programmes, such as Horizon 2020. These deals did not include access for services firms, including financial services. Switzerland retains the ability to negotiate external trade deals with countries outside of the EU. A Civitas report noted that in 2012, Switzerland had deals with countries holding a combined £11.7 trillion in GDP with which the EU did not have agreements[3]. It also noted that Switzerland's deals were more comprehensive and opened up better markets[4].

Like Norway, Switzerland pays into the EU budget at a reduced rate. In recent years Switzerland has paid the net equivalent of £53 per capita to the EU budget[5]. It is also not subject to EU environmental, competition or social and employment regulations, unless it decides to introduce a bilateral agreement to account for them.

Switzerland's relationship with the EU must be renegotiated constantly to reflect the changing EU. It has limited influence on how EU regulations are formed. This leads to the creation of new barriers to trade. In addition the EU is increasingly unhappy with the Swiss arrangements[6], for instance it is challenging Switzerland's imposition of quotas on EU migration[7].

Appendix – Summary of potential scenarios (cont.)

The Turkey option

Turkey, as an EU candidate country, is a member of the Customs Union. In Turkey's case, this covers industrial and processed agricultural goods, but not non-processed agricultural goods[8]. It has autonomy in setting its own regulations, for instance in financial services, but it must comply with EU technical standards and product regulations, not only for goods exported to the EU but also those sold in the domestic market. Turkey must adopt EU rules on competition and state aid.

Although it is subject to product regulations, Turkey has no formal power to influence these. More generally, it is unable to influence the direction of European integration. Furthermore, Turkey has no deals with the EU on services, including financial services, or the free movement of labour[9]. Turkey is also not a part of the Single Market for capital (although it has been able to attract strong levels of foreign direct investment (FDI) from the EU in recent years)[10].

Turkey is forced to accept EU provisions on customs and rules of origin. It must also adopt free trade agreements (FTAs) signed by the EU, even though it is not automatically included in negotiations. This leads to situations where Turkey must accept imports tariff free from certain countries, whilst not being to export to them on the same basis. In order to get the same treatment as the EU, it must negotiate independently with the third country involved, a process which is long and which can still leave Turkish exporters at a disadvantage compared to EU ones[11].

The WTO option

If the UK were to come out of the EU and was unable to negotiate some kind of trade agreement, all rules applying to trade between the UK would be determined by its membership of the WTO. This represents a 'worst case' trade scenario. Under WTO rules, the EU would apply Most Favoured Nation (MFN) tariffs on UK exports. The Confederation of British Industry (CBI) believes this would lead to 'tariffs of significance' on 90% of UK goods exports to the EU[12].

In terms of services, the UK would operate within the WTO's General Agreement on Trade in Services (GATS) framework. However, a large number of non-tariff barriers for foreign suppliers would give UK exporters a much reduced level of access than under the Single Market.

Although the UK would retain free movement of capital with Europe[13], there would no longer automatically be free movement of labour with the EU. Immigration and visa rules would be decided independently by the UK Government. The UK would no longer be subject to EU environmental or employment regulations. It would also no longer pay into the EU budget. The UK would be free to arrange its own FTAs, although it could lose access to those currently negotiated between the EU and other third parties unless specifically renegotiated[14].

Appendix – Summary of potential scenarios (cont.)

The UK option

As an alternative to the 'off the shelf' packages, the UK could negotiate a comprehensive FTA with the EU, encompassing trade in goods and services. This would allow the UK to negotiate a deal appropriate for its size and special interests, for instance in relation to financial services which sought to reduce non-trade barriers. Such an outcome could therefore offer a better long term position.

In practical terms, however, the UK may not be able to achieve this 'best case' scenario. There is a risk that the trade in services component could be weaker, particularly for financial services, because of the slow progress that the EU has made in opening up the market for services, moves by France and Germany to attract financial services to Paris and Frankfurt, as was displayed in openeurope's exercise to simulate negotiations in relation to a Brexit[15].

Any agreement would still impose some additional costs on UK exporters, for instance through anti-dumping, rules of origin laws and additional customs paperwork. In addition, the UK would see a reduced ability to shape EU regulation in goods and services trade and standards, although its exports to the EU would still have to comply with them. The UK would, however, have much greater flexibility in other areas of regulation such as environmental and labour policy. Other bilateral deals could be negotiated in other areas, such as membership of the ETS or the movement of labour.

The outcome for any such negotiations will depend on the level of cooperation between the UK and the EU. As the UK is a significant and important market for EU goods, it has some negotiating power. However, there is precedent that large nations within the EU would take a hard-line stance, for instance Germany's attitude towards austerity in Europe. Furthermore, it is possible that a Europe without the UK would be considerably more protectionist[16]. Negotiations could be hampered by special interests in the EU, similar to those seen in the negotiation of the Transatlantic Trade and Investment Partnership (TTIP) between the USA and the EU[17]. The UK could find itself outside of the EU and reverting to WTO rules, until a FTA can be finalised.

Footnotes

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17. The Economist – "Opening shots: Trade negotiations between American and the European Union will not be smooth", 6 July 2013

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