Report on the Establishment of an EEA Insurer in another Member State

Background

A working group was established by the Financial Markets Law Committee ("**FMLC**") to examine the lack of clarity surrounding the distinction between a (re)insurer providing services in an EEA Member State and becoming established in that Member State (the "**Issue**"). The working group consisted of: David Kendall (Chair), Jennifer Donohue, Reid Feldman, Alison Matthews, Steven McEwan, Martin Membery, Sally Purcell, Jan Putnis and Cheng Li Yow. The working group prepared a draft paper, which served as a previous version of this report, examining the Issue. This report has not been reviewed, approved or adopted by the FMLC but it is published with the permission of the FMLC Secretariat, which was involved in early discussions and project coordination.

In this Report, the Issue is examined with the UK as the primary jurisdiction and within the context of an EEA (re)insurer seeking to do business or doing business in the UK. Some analysis is also included of the law in other EEA Member States, and of related issues affecting non-EEA (re)insurers.

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FOREWORD

1. The distinction between becoming established in another Member State of the European Economic Area ("**EEA**"), by means of some form of presence in that state, and merely selling insurance into that state, is a fine one, although it remains important as the formalities attaching to each are rather different.

2. The Solvency II Directive (2009/138) (the "**Solvency II Directive**") provides that authorisation to take up the business of direct insurance or reinsurance is to be sought from the undertaking's home Member State, shall be valid for the entire Community, and covers the "right of establishment" and the "freedom to provide services".[1]

3. Establishment in a Member State other than the home Member State is done by establishing a branch.[2] A "branch" means "*an agency or a branch of an insurance or reinsurance undertaking which is located in the territory of a Member State other than the home Member State*".[3] Article 145 of the Solvency II Directive provides that any permanent presence of an undertaking in a Member State is to be treated in the same way as a branch even where the presence does not take the form of a branch, but consists merely of an office managed by the undertaking's staff, or by a person who is independent "*but has permanent authority to act for the undertaking as an agency would*".

4. The Solvency II Directive is consistent with guidance given by the European Commission in an Interpretative Communication 2000/C 43/03 "Freedom to Provide Services and the General Good in the Insurance Sector" published in May 2000 (the "**Interpretive Communication**") which is based on case law of the Court of Justice of the European Union ("**CJEU**") relating to non-insurance activities. The Interpretative Communication states that the provision of services involves either no presence in the relevant EU Member State, or at most, temporary presence, while an establishment constitutes a permanent presence, but the distinction is not always clear cut. Thus an insurer who operates in the host Member State through an independent intermediary is to be regarded as established only if the intermediary is under the management or supervision of the insurer, the intermediary is authorised to bind the insurer either in the acceptance of risks or the settlement of losses, and the intermediary is acting under a long-term, continuous relationship.[4]

5. However, the guidance given by the European Commission is subject to interpretation and the distinction between freedom of services and freedom of establishment still remains, in many cases, a grey area.

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1 Articles 14 and 15 Solvency II Directive
2 Article 145(1) Solvency II Directive
3 Article 13(11) Solvency II Directive
4 See paragraph 14-038, *Colinvaux's Law of Insurance*, Robert Merkin, Sweet & Maxwell, 11th Edition, 2016

6. The purpose of this paper is to identify the areas of legal uncertainty and to propose how those areas might be addressed. It includes chapters on how these matters are addressed in other jurisdictions and the possible impact of the UK withdrawing from the EU.

CHAPTER 1

WHAT IS NON-DOMESTIC (RE)INSURANCE ?

1.1 This paper focuses on what we refer to as "non-domestic (re)insurance". By this we mean that a (re)insurance policy is issued by or on behalf of a (re)insurer which has its head office in one jurisdiction (the "**Home Jurisdiction**") for the benefit of a person (the "**Policyholder**") who is situated in another jurisdiction (the "**Host Jurisdiction**").[5]

1.2 It is helpful to start with a fundamental distinction. We are not considering a scenario where the (re)insurer sets up a subsidiary company in the Host Jurisdiction, and the (re)insurance policy is issued by that subsidiary company. In that case, this subsidiary would be a different legal person from the (re)insurer, and the (re)insurance policy would be issued wholly within a single jurisdiction. It would be "domestic".

1.3 Let us make our definition more precise.

1.3.1 The (re)insurer is incorporated in, and authorised by the insurance regulator in, the Home Jurisdiction.

1.3.2 The Policyholder is resident in, or is operating for the purposes of the policy in, the Host Jurisdiction. Note that, for simplicity, we will refer to the beneficiary of the (re)insurance policy as the **Policyholder**, although it could be another insurer where the (re)insurer is providing reinsurance.

1.3.3 A (re)insurance policy must be issued by, <u>or on behalf of</u>, the (re)insurer. The words "or on behalf of" are critical to the uncertainty that is examined in this paper.

1.4 Three scenarios can be easily classified.

1.4.1 Suppose the (re)insurer never leaves the Home Jurisdiction, but is contacted by the Policyholder by telephone, following the Policyholder seeing an advertisement placed by the (re)insurer in the Host Jurisdiction. Here the (re)insurer would be regarded as providing services in the Host Jurisdiction, but there is no sense in which it would have an establishment in the Host Jurisdiction.

1.4.2 Suppose that the policy is not concluded by telephone, so the (re)insurer agrees to send one of its employees to the Host Jurisdiction to conclude negotiations of the policy. The employee lives and normally works in the Home Jurisdiction, but makes a special trip to the Host Jurisdiction, concludes the negotiations, signs the policy, and travels home the same day. Again, the (re)insurer would be regarded as providing services in the Host Jurisdiction,

[5] We could have used the term "cross-border (re)insurance" but chose against that for fear of confusion with the term "cross-border services", which normally means the provision of services without having an establishment in the Host Jurisdiction.

and there is no sense in which it would have an establishment in the Host Jurisdiction.

1.4.3 Suppose that the (re)insurer is doing so much business in a particular Host Jurisdiction that it decides to employ 10 people to work permanently on its behalf in the Host Jurisdiction. These people will work from an office located in the Host Jurisdiction, and will use this office as their base to contact potential Policyholders, and to negotiate and sign (re)insurance policies. Here, the (re)insurer would be regarded as having an establishment in the Host Member State.

1.5 In many cases, non-domestic (re)insurance arrangements follow the pattern of one of the above scenarios. However, frequently the distinctions become blurred. This is often because the (re)insurer makes use of one or more third party agents who are themselves based permanently in the Host Jurisdiction, but who are only authorised to act on behalf of the (re)insurer for limited purposes, or for a limited time. The (re)insurance policy is signed by the agent on behalf of the (re)insurer without any of the employees of the (re)insurer having to come to the Host Jurisdiction.

1.6 The appointment of an agent is typically done through a "delegated authority", pursuant to which the (re)insurer delegates authority to the agent to enter into the (re)insurance policy. We consider delegated authorities in Chapter 2.

1.7 It is important to distinguish a delegated authority from the role of an insurance broker. Typically, though not always, an insurance broker acts as agent of the Policyholder, not as agent of the (re)insurer. This adds a further dimension of complexity to the arrangement, as it may be that the broker will negotiate the (re)insurance Policy with an agent of the (re)insurer who has been appointed under a delegated authority, or even that a single entity performs both roles. In this paper, we will generally ignore the distinction between the broker and the Policyholder, and treat them as though they were a single entity.

1.8 For the purposes of analysis in this paper, we have constructed four scenarios (the "**Scenarios**") which create difficulties of classification as between "freedom to provide services" and "freedom of establishment". We describe these scenarios below:

Scenario 1

1.9 **Insurer ABC has its head office in France (Home Jurisdiction). It appoints D as its underwriting agent in London, UK (Host Jurisdiction) to underwrite D&O insurance up to a maximum level of $10m without limit as to terms or form; to collect premium; and to handle and pay claims. D consults with ABC regularly and changes its underwriting guidelines in accordance with ABC's requests. D accounts for premiums received and claims paid monthly. The agency agreement may be terminated by six months' notice with effect from 31 December.**

Is ABC acting in the UK on a freedom of services or a freedom of establishment basis? Do the following matters affect the analysis?

(a) **D is also appointed as underwriting agent by insurers DEF and GHI on the same terms.**

(b) **D is in the same corporate group as ABC. Does it matter whether**

- **D is an affiliate of ABC or a subsidiary?**
- **D has common directors with ABC?**

(c) **Instead of the agency agreement being terminable upon six months' notice with effect from 31 December, the agreement is concluded for a fixed term, expiring on 31 December 2019. During the fixed term, each party still has the ability to terminate the agreement by six months' notice on or before 31 December each year.**

Scenario 2

1.10 **D is an underwriting agent in Manchester, UK (Host Jurisdiction) and is appointed coverholder by EU insurers X, Y and Z (re)insurers with head offices in Home Jurisdictions in the EEA outside the UK) under a binding authority to underwrite personal accident insurance to be renewed annually. D accepts risks in accordance with underwriting guidelines set out in the binding authority either on-line or by telephone. D is not authorised to handle claims, which are handled by an independent TPA.**

Are X, Y and Z acting in the UK on a freedom of services or a freedom of establishment basis?

Scenario 3

1.11 **ABC has a liaison office in London, UK (Host Jurisdiction) staffed by a director, an underwriter and four administrative staff. The director and underwriter meet with brokers and refer them to ABC's head office in Paris, France (Home Jurisdiction) if they think that the brokers have business that would be of interest to ABC. ABC is only interested in commercial insurance and reinsurance. The London staff also deal with administrative issues that arise on risks underwritten by ABC in Paris and liaise over claims.**

Is ABC acting in the UK on a freedom of services or a freedom of establishment basis?

Scenario 4

1.12 **Consider the position under scenarios 1 and 3 on the assumption that ABC is incorporated in Japan (Home Jurisdiction) and headquartered in Tokyo, but that the relevant activities of D (in scenario 1) and the liaison office (in scenario 3) are carried out in the UK as before.**

In each case, is ABC acting in the UK on a freedom of services or a freedom of establishment basis?

1.13 In each of these four scenarios, the agents or employees are located permanently in the Host Jurisdiction, but they have authority to act for the (re)insurer only for limited purposes or for a limited time. This distinguishes them from the employee in paragraph 1.4.2 who comes to the Host Jurisdiction to sign the (re)insurance policy and then returns home to the Home Jurisdiction, and from the office in the Host Jurisdiction in paragraph 1.4.3 that 10 employees of the (re)insurer use as a permanent base.

1.14 Importantly, the answer does not lie simply in whether the (re)insurer is or is not the legal employer of the person who conducts the relevant activities. It is entirely possible for an agent appointed under a delegated authority to be an "establishment" of the (re)insurer, even though there is no employer-employee relationship.

1.15 Nor is the answer dependent on whether the company law of the Host Jurisdiction would regard the (re)insurer as having a "branch". Where the person who conducts the activities is a third party then it would not be regarded as part of same company as the (re)insurer, but it is possible that it could be an "establishment" for regulatory purposes.

1.16 It is of note that the first three scenarios specifically consider EU jurisdictions. This is because the concepts of "freedom to provide services" and "freedom of establishment" are concepts specifically recognised in the Treaty on the Functioning of the European Union, and developed by subsequent legislation, interpretive guidance and case law. (Re)insurers who make use of these freedoms are said to "passport" from one EU member state to another.

1.17 These freedoms are extended by the Agreement on the EEA so that they apply as between jurisdictions of the EEA and jurisdictions of the EU.

1.18 These freedoms have no specific meaning outside the context of two EEA member states. In particular, a non-EEA (re)insurer cannot "passport" into an EEA jurisdiction, either on a freedom of services or a freedom of establishment basis. Nevertheless, many of the ideas considered in this paper are still of importance to a non-EEA (re)insurer, and for that reason we have included Scenario 4 and included more detailed analysis of the applicable law in Chapter 7. This will become important in the context of the UK leaving the EEA as a result of Brexit, the implications of which are considered in Chapter 8.

1.19 The "freedom to provide services" and the "freedom of establishment" are particularly important features of the EEA insurance regime because they can be exercised without the (re)insurer having to obtain a further authorisation from the insurance regulator in the Host Jurisdiction. The original authorisation from the insurance regulator in the Home Jurisdiction is sufficient. For insurers there is a notification process that must be followed, but this is straightforward and generally does not depend on any discretion on the part of the regulator, provided that in the case of establishment of a branch the regulator, taking account of the planned scheme of operation, does not have reason to doubt the adequacy of the insurer's system of governance, financial situation or compliance with "fit and proper" requirements (see Solvency II Directive articles 145 and 146). (For pure reinsurers the Solvency II Directive does not provide for such formal notification procedures.) As a result, it is possible to avoid lengthy delays that would

arise if a (re)insurer had to obtain permission in each Host Jurisdiction where it wished to carry on business.

1.20 Although both types of freedom can be exercised without having to obtain a further authorisation, there are nevertheless some important differences between them. We explore some of these differences in Chapter 4.

1.21 This paper is focused on the uncertainty that arises because an EEA (re)insurer may not know which of the two freedoms will apply in a particular scenario. For the reasons given in Chapter 3, this distinction is important and needs to be clarified. We highlight some of the particular areas of uncertainty throughout this paper, including, in Chapter 8 of the issues emerging from the growth of the digital single market.

1.22 Finally, in Chapter 9 we summarise the areas of uncertainty in this area.

Implications for insurance intermediaries

1.23 Although this paper frequently mentions insurance intermediaries (such as underwriting agents, coverholders and brokers), it is primarily focused on the implications that using the intermediary will have for the (re)insurer – in particular, on whether the reinsurer will be regarded as operating through an establishment or on a freedom of services basis.

1.24 However, it should be borne in mind that under Insurance Distribution Directive (2016/97) and its predecessor, the EU Insurance Mediation Directive (2002/92) an insurance intermediary authorised in one Member State is able to passport into other Member States, again on a freedom of establishment or freedom of services basis. Such intermediaries may themselves engage agents who are resident in the Host Jurisdiction, and the same questions will arise about whether the agents are an establishment of the intermediary or whether they are sufficiently independent of the intermediary that the intermediary should be regarded as operating on a freedom of services basis.

1.25 The issues discussed in this paper are therefore of wider interest to the insurance industry, as they affect both (re)insurers and insurance intermediaries.

CHAPTER 2

DELEGATED AUTHORITIES

2.1 As briefly explained in Chapter 1, (re)insurers often use "delegated authority" agreements to appoint agents to act on their behalf in negotiating and signing (re)insurance policies. The agent is often called a "coverholder" or "underwriting agent", and the terms of his authority are set out in the delegated authority agreement. A delegated authority agreement is also sometimes called a "binding authority agreement" or "binder" for short. Under a delegated authority agreement, the agent may or may not be in the same jurisdiction as the (re)insurer. An agent in the same jurisdiction as the (re)insurer may be used because of its distribution capabilities generally or because it has a particular area of expertise. An agent in a different jurisdiction may be used because of its local resources and its knowledge of the local market. This paper focuses on the latter scenario. The FCA has recently conducted a thematic review into the use of delegated authorities in the UK general insurance marketplace[6] and published its report in June 2015. We set out below relevant extracts from the FCA report:

2.1.1 *Insurers and intermediaries operating in the UK general insurance marketplace have developed a wide range of business models in order to meet the insurance needs of customers. One of the key components underpinning the diversity in business models is the delegation of authority to third parties.* (Para 1.1)

2.1.2 *The term 'delegated authority' is widely used in the general insurance industry to describe a variety of arrangements. At the core of these arrangements is external delegation by insurers, involving the outsourcing of functions to intermediaries and other third parties.*[7] *This is often accompanied by the allocation of other related functions between the parties involved.* (Para 1.2)

2.1.3 *Outsourcing and any accompanying allocation of functions can take many different forms and can relate to all stages of an insurance product life-cycle from product development, through underwriting, distribution and sales, to claims and complaint handling.* (Para 1.3)

2.1.4 *In selecting a sample of firms for this review it became apparent how many firms included outsourced underwriting, outsourced claims handling and other outsourcing arrangements within their business models. We are aware, for example, that the Lloyd's market received circa 30% of its premium income in 2013*[8] *through firms that held underwriting authority on behalf of Lloyd's syndicates. Although the extent and nature of outsourcing varied considerably, we found examples of outsourcing across the full spectrum of insurers we considered as part of the review. This ranged from large composite insurers to small insurers with particular underwriting specialisms.* (Para 1.7)

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[6] "*Delegated authority: Outsourcing in the general insurance market*". Thematic Review TR 15/7, June 2015

[7] Systems and Controls – FCA Handbook SYSC 3.2.4 G describes external delegation as 'outsourcing', noting that 'guidance relevant to delegation within the firm is also relevant to external delegation ('outsourcing').

[8] Lloyd's Annual Report 2013, pg 17

2.1.5 *In our sample of insurers, the proportion of business underwritten through delegated authority ranged from 10% to 100%, with this accounting for the majority of business for two of the insurers in our sample. In many cases firms also outsourced claims handling or other elements of product provision or servicing. Additionally outsourcing and the allocation of related functions is a feature of both the distribution of insurer-led products and the creation, delivery and servicing of products developed and managed by intermediaries.* (Para 1.8)

2.1.6 *Delegation is a feature of the way that parts of the general insurance market operates. The term 'delegation' is frequently used by firms where outsourcing is taking place. The Handbook defines outsourcing as 'the use of a person to provide customised services to a firm' (other than a member of the firm's governing body or an individual employed by the firm) or 'an arrangement of any form between a firm and a service provider by which that service provider performs a process, a service or an activity which would otherwise be undertaken by the firm itself'.*[9] (Para 2.1)

2.1.7 *This means that external delegation of underwriting authority and other significant functions such as claims handling is by definition outsourcing and subject to the relevant requirements in the Handbook. All of the arrangements considered in the context of this review involved outsourcing of some functions by the insurer to regulated intermediaries or other third parties operating as service providers.* (Para 2.2)

2.1.8 *Some incoming firms that passport into the UK on a services basis may not have considered whether or not they have established a branch by virtue of the functions they have outsourced to agents in the UK. Whether this is the case depends on the facts and various factors in line with established case law. The EU Commission has also produced some guidance on this subject.*[10] *We would expect firms to have obtained appropriate advice if they are unsure of the position.* (Para 2.26)

2.2 As the FCA's Thematic Review acknowledges, there are a variety of ways by which insurers delegate authority to third parties to conduct insurance business on their behalf. The main ones are:

2.2.1 Appointment of a Managing General Agent or underwriting agent with authority to underwrite one or more classes of business on behalf of one or more insurers, usually also with authority to handle and settle claims on the insurances it has underwritten.

2.2.2 Appointment of a coverholder pursuant to a binding authority which authorises the coverholder to issue certificates of insurance on behalf of one or more insurers (including Lloyd's syndicates, in which case the coverholder and binding

[9] http://fshandbook.info/FS/glossary-html/handbook/Glossary/O?definition=G814 Although the definition in the FCA Handbook consists of the two limbs described above, only the second limb applies to Solvency II firms (the first is taken from the MiFID). The PRA Rulebook defines "outsourcing" as "an arrangement of any form between a firm and a service provider, whether a supervised entity or not, by which that service provider performs a process, a service or an activity, whether directly or by sub-outsourcing, which would otherwise be undertaken by the firm itself", which is consistent with the second limb of the definition quoted above and with Article 13(28) of the Solvency II Directive.

[10] See Commission Interpretative Communication – Freedom to provide services and the general good in the insurance sector (2000/C 43/03).

authority are subject to Lloyd's regulatory supervision). The coverholder may or may not have authority to handle claims.

2.2.3 In many instances, the coverholder is also an insurance broker who both introduces and underwrites (on behalf of its principal insurers) its clients' insurance risks.

2.2.4 Insurers may delegate the handling of claims to Third Party Administrators ("**TPA**"**s**) with authority to handle and settle claims on insurances underwritten by the insurer or by a coverholder.

2.2.5 An insurer may enter into a co-insurance agreement with other insurers whereby the authority to accept insurance risks is delegated by the co-insurers to the first insurer, including by way of a lineslip or consortium arrangement.

2.2.6 Insurance may be sold by retailers or service providers in conjunction with the products or services that are being sold (for example, as warranties for the performance of electrical goods), in which case the retailer or service provider may be acting as agent for the insurer in arranging the insurance.

2.3 There are therefore a wide range of circumstances in which the issues considered in this paper may arise.

CHAPTER 3

EU LAW AND GUIDANCE

3.1. INTRODUCTION

3.1.1. This chapter considers the law regarding the rights of an EEA (re)insurer to passport into the UK on a freedom of establishment or a freedom of services basis. This includes examination of relevant decisions of the CJEU and interpretive guidance given by the European Commission.

3.1.2. Because this chapter is focused on EEA (re)insurers, we use the terms "**Home Member State**" and "**Host Member State**" rather than Home Jurisdiction and Host Jurisdiction as we did in Chapter 1.

3.1.3. In many places we have referred to provisions of the Solvency II Directive. The Solvency II Directive is not directly effective in Member States of the EEA. Instead, it has to be implemented by local law and regulation. For example, in the UK, it is implemented largely through the provisions of the Financial Services and Markets Act 2000 (as amended) and rules made by the Prudential Regulation Authority and the Financial Conduct Authority. However, since the ultimate source of the law is the Solvency II Directive, it is helpful to refer directly to its provisions. Chapters 5 and 6 consider the applicable law in the UK and in certain other EEA Member States.

3.2. THE EU TREATY AND THE EEA AGREEMENT

3.2.1. The principles of freedom of establishment and freedom of services are derived from the Treaty on the Functioning of the European Union (the "**TFEU**").

3.2.2. In relation to the freedom of establishment, Article 49 of the TFEU provides:

> "*Within the framework of the provisions set out below, restrictions on the freedom of establishment of nationals of a Member State in the territory of another Member State shall be prohibited. Such prohibition shall also apply to restrictions on the setting-up of agencies, branches or subsidiaries by nationals of any Member State established in the territory of any Member State.*
>
> *Freedom of establishment shall include the right to take up and pursue activities as self-employed persons and to set up and manage undertakings, in particular companies or firms within the meaning of the second paragraph of Article 54, under the conditions laid down for its own nationals by the law of the country where such establishment is effected, subject to the provisions of the Chapter relating to capital.*"

3.2.3. In relation to the freedom of services, Article 56 of the TFEU provides:

> "*Within the framework of the provisions set out below, restrictions on freedom to provide services within the Union shall be prohibited in respect of nationals of Member States who are established in a Member State other than that of the person for whom the services are intended.*
>
> …
>
> *Without prejudice to the provisions of the Chapter relating to the right of establishment, the person providing a service may, in order to do so, temporarily pursue his activity in the Member State where the service is provided, under the same conditions as are imposed by that State on its own nationals.*"

3.2.4. In relation to both of the above articles, Article 54 of the TFEU provides that companies or firms are to be treated in the same way as natural persons who are nationals of Member States – making clear that these freedoms are intended to be available to companies and firms and not only to individuals.

3.2.5. The TFEU applies as between the 28 Member States of the European Union. These 28 countries have entered into the Agreement on the European Economic Area (the "**EEA Agreement**") with the states of Iceland, Liechtenstein and Norway. The EEA Agreement includes provisions very similar to Article 49, 54 and 56. Under Article 7 of the EEA Agreement, Acts referred to or contained in the Annexes to the Agreement are binding upon the parties and are required be made part of their internal legal order. Annex IX expressly includes the Solvency II Directive among these Acts.

3.3. PASSPORTING UNDER SOLVENCY II

3.3.1. EEA authorised (re)insurers have the right to pursue (re)insurance business throughout the EEA under the principles of the freedom to provide services and the freedom of establishment laid down in the TFEU and the EEA Agreement. These rights, known collectively as "passporting" rights, have been consolidated and reaffirmed under the Solvency II Directive. Passporting rights are exercised where a (re)insurance policy is entered into by, or on behalf of, a (re)insurer incorporated and authorised in one member state (the "**Home Member State**") for the benefit of a Policyholder who is resident in, or operating for purposes of the policy in, another member state (the "**Host Member State**").[11]

[11] The home Member state of a (re)insurance undertaking is defined in the Solvency II Directive as the Member State in which the head office of the undertaking covering the risk (non-life) or the commitment (life) is located. Each other member state into which the (re)insurance undertaking may wish to provide services is the 'host member state'

3.3.2. Whilst the principles that underpin passporting rights are broadly the same in respect of both the freedom of establishment and the freedom to provide services, the pre-conditions (being the applicable notification requirements) are different in each case. It is, therefore, important for (re)insurers to know which passport right their activities fall within.

3.4. PASSPORTING NOTIFICATION REQUIREMENTS

Freedom to provide services:

3.4.1. Article 147 of the Solvency II Directive provides that any insurer[12] that intends to pursue business for the first time in a Host Member State under the freedom to provide services must first notify the supervisory authorities of the Home Member State (the "**Home Member State supervisor**"), indicating the nature of the risks that it intends to cover. Under Article 148 of the Solvency II Directive, the Home Member State supervisor then has one month in which to communicate certain information to the Host Member State, including a certificate attesting that the insurer covers the Solvency Capital Requirement ("**SCR**") and the Minimum Capital Requirement ("**MCR**"). The insurer may commence business in the Host Member State from the date on which it is informed that the communication has been made (if it is not made then it has the right of appeal to the courts in its Home Member State).

Freedom of establishment:

3.4.2. The conditions for branch establishment of an insurer in a host Member State are set out in Articles 145 and 146 of the Solvency II Directive.

3.4.3. We first consider the meaning of "branch" in the Solvency II Directive and then proceed to summarise the conditions for establishing a branch.

Meaning of branch

3.4.4. Under Article 13 of the Solvency II Directive, a branch is defined as follows:

> *'branch' means an agency or a branch of an insurance or reinsurance undertaking which is located in the territory of a Member State other than the home Member State;*

3.4.5. Article 145(1) (§ 2)[13] supplements this as follows:

> "*Any permanent presence of an undertaking in the territory of a Member State shall be treated in the same way as a branch, even where that presence does not take the form of a*

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[12] In this chapter we use the term "insurer" (as opposed to (re)insurer) to mean an insurer that carries on direct business, and to exclude a pure reinsurer – that is, an entity which only carries on reinsurance business. Note that an "insurer" may carry on reinsurance business as well as direct business.

13 Article 145 is applicable to insurers but might apply by analogy to pure reinsurers as well.

branch, but consists merely of an office managed by the own staff of the undertaking or by a person who is independent but has permanent authority to act for the undertaking as an agency would."

3.4.6. As will be considered in more detail below, this supplementary wording appears clearly influenced by the Interpretive Communication, although without all of the detail of the three tests laid down by the Interpretive Communication.

3.4.7. It is useful to compare this definition, which applies for purposes of passporting, with the definition of "branch" that applies in Article 162 when determining whether an EEA branch of a non-EEA insurer requires an authorisation:

> *'branch' means a permanent presence in the territory of a Member State of an undertaking [with a head office outside the EEA which is accessing direct life and non-life insurance business in EEA], which receives authorisation in that Member State and which pursues insurance business.*

3.4.8. Interestingly, there is no reference to "agency" or an independent person. On the other hand, there is a requirement that the branch "pursues insurance business", which is not included in the definition that applies for purposes of passporting. This leaves open the question whether a passporting notification would be needed if the branch of a (re)insurer carried out no (re)insurance activities in the Host Member State. A literal interpretation would suggest that it would be needed. This is considered further in paragraph 3.7 below.

Conditions of establishing a branch

3.4.9. Prior to establishing a branch, an EEA insurer must notify its Home Member State regulator and, additionally, provide certain information specified in Article 145(2). This includes a scheme of operations setting out the types of business envisaged and the structural organisation of the branch and details of a local representative with the power to bind the insurer. Unless the Home Member State supervisor has reason, in light of the planned scheme of operations, to doubt the adequacy of the insurer's governance, financial situation or compliance with "fit and proper" requirements, it must, within three months, communicate this information to the Host Member State (as well as attesting that the insurance undertaking satisfies its SCR and MCR). In the event that the Home Member State supervisor refuses so to communicate this information, this is subject to a right of appeal by the insurance undertaking in the courts of its Home Member State. The insurer may establish the branch and start business within two months of the Home Member State Supervisor communicating the information to the Host Member State supervisor or, if earlier, from the date on which its Home Member State supervisor receives a communication from the Host Member State supervisor informing it of the conditions under which, in the interests of the general good, the business in the Host Member State must be pursued.

Pure reinsurers:

3.4.10. Reinsurers[14] may also provide services under passporting rights. There are no specific notification requirements applicable to reinsurers prescribed in the Solvency II Directive; however, there is a general requirement under Article 158 of the Solvency II Directive that a reinsurer must comply with "the legal provisions applicable to it" in the Host Member State. In the event that the reinsurer fails so to comply, the Host Member State may "take appropriate measures to prevent or penalise" the reinsurer. There are no other express provisions in the Solvency II Directive relating to passporting by reinsurers.

3.4.11. It is notable that in the United Kingdom, the Financial Services and Markets Act 2000 provides that a pure reinsurer which establishes a branch in the United Kingdom, or provides services in the United Kingdom, in exercise of an EEA right (which includes a right under Solvency II) automatically qualifies for authorisation. No prior notification is required.

Community co-insurance

3.4.12. Article 190 of the Solvency II Directive provides that Articles 147 to 152 of the Solvency II Directive do not apply to EEA insurers whose business in the Host Member State is limited to certain types of co-insurance operations[15], and which act only as the following insurer (and not as the lead insurer) in those operations. Accordingly, such insurers do not need to go through the notification process described above in order to participate in such co-insurance policies, even where the policies are negotiated and entered into in the Host Member State.

Motor insurance

3.4.13. Article 152 of the Solvency II Directive applies in a situation where an insurer provides motor insurance by way of cross-border services, rather than from an establishment in the Host Member State. In this case, it is required to establish a representative that is resident or established in the Host Member State and which:

> "*shall possess sufficient powers to represent the [insurer] in relation to persons suffering damage who could pursue claims, including the payment of such claims, and to represent*

[14] In this paper the term "reinsurer" is used to mean an entity whose business consists of providing reinsurance to other insurance and reinsurance entities, and which is not authorised to provide insurance other than such reinsurance. Importantly, therefore, it cannot provide direct insurance to members of the public. Such entities are referred to in insurance regulation as "pure" reinsurers. The term "reinsurer" is distinguished from the term "(re)insurer", by which we refer to both insurers and pure reinsurers.

[15] Co-insurance means insurance of a large risk written by two or more insurers each of whom assumes liability for a specified proportion of the risk. Usually one of the insurers (the "lead insurer") is given authority by the others (the "following insurers") to set the terms of policies and to settle claims on their behalf. From the policyholder's perspective, therefore, the arrangement is equivalent operationally to a policy with a single insurer. For the exception for "Community co-insurance" to apply under Article 190, the co-insurance must be of a large risk situated in the EEA and the lead insurer must be authorised in a Member State and at least one of the other co-insurers must contract through a head office or branch established in a Member State. The lead insurer must assume the leader's role in the co-insurance practice and accordingly determine the terms and conditions of the co-insurance and its rating. Where the exception applies, the services passporting notification rules apply only to the lead insurer and not to the following insurers. The establishment passporting notification rules are not disapplied, so if any of the following insurers operate through a branch in the relevant Member State for purposes of the coinsurance, an establishment passporting notification would be required.

it or, where necessary, to have it represented before the courts and authorities of [the Host] Member State in relation to those claims."

3.4.14. Under the wide definition of "branch" considered above, there would clearly have been a risk that the representative would constitute a "branch" of the insurer, so that an establishment passporting notification would be required. However, Article 152 provides that the appointment of the representative shall not in itself constitute the opening of a branch for the purpose of Article 145.

3.5. SIGNIFICANCE OF PASSPORTING RIGHTS

3.5.1. If a passporting right is exercised correctly then the (re)insurer will automatically be authorised to carry on (re)insurance business in the Host Member State. It will be exempt from local laws that would otherwise make it unlawful to carry on (re)insurance business in the Host Member State without an authorisation from the insurance regulator in the Host Member State.

3.5.2. This shows the importance of understanding the scope of each type of passporting right, so that each of them can be exercised correctly. The consequences of failing to follow the correct procedure would be a matter for the law of each individual Member State, but at the very least it would entitle the Host Member State to require the (re)insurer to cease to carry on (re)insurance business in the Host Member State until such time as it has properly complied with the appropriate requirements.

3.5.3. Chapter 3 examines other consequences of the distinction between the two types of passporting rights.

3.6. DISTINCTION BETWEEN RIGHT OF ESTABLISHMENT AND FREEDOM TO PROVIDE SERVICES

General Comment

3.6.1. As explained in Chapter 1, it is not always easy to determine whether, in a particular context, a (re)insurer is acting through an establishment or is merely providing services. Some situations are difficult to classify – for example, where the (re)insurer, in order to carry on its (re)insurance business, uses a permanent infrastructure in the Host Member State. This arises in particular in the case where the (re)insurer has recourse to independent persons established in the Host Member State.

3.6.2. On 16 February 2000 the European Commission issued the Interpretative Communication, which is a non-binding guideline summarising its view of the case law of the CJEU as at that date. The guidance contained in the Interpretive Communication has, subject to certain minor nuances, been broadly accepted in the UK and across much of the EEA as effectively setting out the position on distinguishing the freedom to

provide services as against the right of establishment. In particular, the language of Article 145(1) of the Solvency II Directive, quoted above in paragraph 3.4.2, is directly drawn from the Interpretive Communication.

3.6.3. The Interpretive Communication provides that, for the links between an independent person and an insurance undertaking to be regarded as meaning that the (re)insurer falls within the scope of the rules governing the freedom of establishment rather than those applicable to the freedom to provide services, the independent person must meet the following three cumulative conditions:

a. he must be subject to the direction and control of the (re)insurer he represents;
b. he must be able to commit the (re)insurer; and
c. he must have received a permanent brief.

3.6.4. The Commission takes the view that it is only where the above three conditions are met that a (re)insurer is to be treated as operating an establishment in the Host Member State, and must therefore comply with the relevant notification provisions outlined at paragraph 3.4.2 above. It should be noted that this does not mean that the independent person himself or itself constitutes a branch of the (re)insurer. A branch is "a place of business which forms a legally dependent part of an insurance undertaking"[16]. Since the person is assumed to be independent, he cannot be a "part" of a (re)insurer. It is therefore possible for a (re)insurer to be regarded as having a regulatory establishment in the Host Member State without having a branch of its company there.

Three cumulative conditions

a. independent person must be subject to the direction and control of the (re)insurer

3.6.5. The relevant factor here will be whether, in the light of the links between the (re)insurer and the independent person, the latter has sufficient freedom to organise his activities, to decide how much time he will devote to the (re)insurer and, in particular, to represent competitors at the same time. For instance, a brief received by an independent person from a single (re)insurer requiring the independent person to act exclusively for the (re)insurer is an indication that the independent person is subject to the direction and control of that (re)insurer. The Interpretive Communication makes it clear that if the intermediary receives an exclusive brief from one insurer, that insurer may have a branch through that relationship even though the intermediary also works for other insurers.

3.6.6. The existence of a controlling shareholding by the (re)insurer in the capital of the "independent person" is likely to be indicative that the (re)insurer controls that person and that this condition may be fulfilled as a result.

[16] "Branch" is not in fact fully defined in the Solvency II Directive itself but see footnote 34 to the Interpretive Communication.

b. independent person must be able to commit the (re)insurer

3.6.7. To determine whether this condition is satisfied, the issue is whether the acts or decisions of the independent person can commit the (re)insurer vis-à-vis third parties, who therefore do not need to deal with the (re)insurer itself.

3.6.8. The commitment of the (re)insurer vis-à-vis the insured results primarily from the brief given to the independent person to conclude (re)insurance policies with those seeking (re)insurance on behalf and for the account of the (re)insurer not established in the Host Member State. Such a brief would usually be recorded in an agency agreement between the (re)insurer and the independent person. If the independent person can, for instance, make an invitation to treat on behalf of the (re)insurer to a client containing all the essential terms of the proposed policy, but the (re)insurer can still refuse the proposal if it is submitted by the independent person and signed by the client, the condition of the ability to commit will not be met.

3.6.9. In some cases, other elements of the brief given by the (re)insurer to an independent person may also show the intention of the (re)insurer to be directly committed to the policyholder. For example, where the (re)insurer has granted the independent person the power to decide to accept and settle a claim submitted to it, and the decisions taken by the independent person bind the (re)insurer vis-à-vis third parties, then the ability to commit will be met.

c. independent person must have received a permanent brief

3.6.10. The capacity of an independent person (e.g. an intermediary) established in the Host Member State to commit a (re)insurer must be based on a long-term, continuous brief and not a brief that is limited in time or a one-off instruction. The "stable and continuous" quality of such a brief would indicate that the (re)insurer intends to integrate its activities into the economy of the Host Member State.

3.6.11. However, in the Commission's opinion, where a (re)insurer merely has recourse, in order temporarily and occasionally to carry on insurance business in a Host Member State, to an intermediary established in that Host Member State, its activities fall within the scope of the rules governing the freedom to provide services rather than the freedom of establishment. Furthermore, the Commission considers that a (re)insurer that decides to transact insurance business under the freedom to provide services must be able to use certain services either upstream or downstream of the transaction in the Host Member State without being treated as having established itself in the Host Member State. For example, a (re)insurer should be able to use for its business:

i. a local expect to assess risk or damage;
ii. canvassers who do not conclude insurance policies and whose activity is limited to sending insurance proposals receive from potential policyholders to the insurance undertaking for acceptance;

iii. local legal services, medical or actuarial services established in the Host Member State; and

iv. a permanent structure for collecting premiums or notices of claims or managing files relating to claims.

3.6.12. In the Commission's view, it is only where the independent person's brief "concerns…the business of insurance" that it will result in it being treated in the same way as an establishment of the (re)insurer.

Has the Interpretive Communication been superseded by the Solvency II Directive ?

3.6.13. The Interpretive Communication represents the views of the European Commission, and is not binding law. As will be seen in Chapters 5 and 6, regulators in EEA Member States have adopted varying perspectives on it, and none has wholeheartedly embraced it.

3.6.14. A further question is whether the Interpretive Communication, written in 2000, was intended to be overridden by the Solvency II Directive, which was first published in 2009. It is possible that the definition of "branch" in Article 145(1) was intended to incorporate as much of the views in the Interpretive Communication as the EU wished to represent the law in the EU in 2009.

3.6.15. Article 145(1)(¶2)[17] provides:

> "*Any permanent presence of an undertaking in the territory of a Member State shall be treated in the same way as a branch, even where that presence does not take the form of a branch, but consists merely of an office managed by the own staff of the undertaking or by a person who is independent but has permanent authority to act for the undertaking as an agency would*."

3.6.16. The text of this provision clearly engages with the same subject matter as the Interpretive Communication by contemplating the possibility that an independent person could be treated as a branch, and the concept of "permanent authority to act" may be regarded as reflecting the second and third parts of the three part test laid down by the Interpretive Communication – namely, "ability to commit" and "permanent brief".

3.6.17. However, Article 145(1) contains no express reference to first part of the three part test laid down by the Interpretive Communication – namely, the need for "direction and control" by the (re)insurer. It may be that this is captured by the words "as an agency would", on the basis that an agency may operate under direction and control of its principal, but that is not certain, and certainly agency arrangements exist where the agent is relatively free of the direction and control of its principal.

[17] See footnote 13.

3.6.18. As the Solvency II Directive is maximum and minimum harmonising, it is also arguable that Member States who impose the "direction and control" test as a further condition are not properly implementing the Directive.

3.6.19. There is therefore considerable doubt about whether the "direction and control" requirement continues to apply.

National provisions protecting the general good

3.6.20. Recital 85 of the Solvency II Directive provides that, in order to "protect the general good", Member States may "adopt or maintain such legal provisions in so far as they do not unduly restrict the right of establishment or the freedom to provide services." The "general good" is not defined in the Solvency II Directive, but the Interpretive Communication offers guidance on what, in the Commission's view, will constitute an acceptable restriction on passporting rights of (re)insurers. In general terms, the national provision must:

a) come within a field that has not been harmonised;
b) pursue an objective of the general good (the Interpretive Communication includes a non-exhaustive list which includes consumer protection, prevention of fraud and the cohesion of the tax system);
c) be non-discriminatory
d) be objectively necessary
e) be proportionate to the objective pursued; and
f) not be safeguarded by rule to which the provider of services is already subject in its home Member State.

3.6.21. There has been relatively little case law of the CJEU directly relevant to the concept of the general good as applied to the issue of distinguishing the freedom of establishment from the freedom to provide services. However, similar issues were considered in the case of *Commission of the European Communities v Denmark* (C-150/04). The case considered provisions of Danish tax legislation that had the effect, broadly, that in order for pension institutions established in other Member States to offer their services on the Danish market with the same tax advantages as those offered by pension institutions established in Denmark, they must have a branch office or a permanent establishment in Denmark. The result was that pension institutions in Member States other than Denmark were dissuaded from seeking to carry on business in Denmark, since they would either have to establish themselves there through a branch, and thereby incur the cost of doing so, or operate on a freedom of services basis but accept that potential customers would not benefit from the same tax advantages as they would by dealing with a pension institution established in Denmark. Potential customers would therefore be dissuaded from buying their services. The CJEU held that the tax measures went beyond what was necessary to pursue the legitimate objective of protecting the cohesion of the Danish tax

system, and were therefore an unlawful restriction on the freedom to provide services and the freedom of establishment.

3.7. NOT PURSUING BUSINESS IN A MEMBER STATE

3.7.1. In the previous section, it was envisaged that the (re)insurer would have some form of representation or presence in the Host Member State, and the question being considered was whether this would mean it was treated as having a branch so as to necessitate an establishment passporting notification. As explained in paragraph 3.5.1, this is a critical question.

3.7.2. A related question is whether the representation or presence could be so insignificant that the (re)insurer is not even regarded as carrying on business in the Host Member State. This is an important question because it could mean that the (re)insurer would not have to comply even with the requirements for passporting on a "freedom of services" basis.

3.7.3. Article 147 of the Solvency II Directive requires an insurer to follow the notification process described in paragraph 3.4.1 above when "it intends to pursue business for the first time in" the Host Member State "under the freedom to provide services".

3.7.4. The term "pursue business" is not defined, but it is likely to include a much wider range of activities than are required to constitute the creation of a branch. It seems implicit from the Interpretive Communication that any deliberate attempt to communicate with potential policyholders, including temporarily through an independent person who has no right to commit the insurer, will amount to "pursuing business" for this purpose. However, this point is not explicitly stated in the Interpretive Communication.

3.7.5. The words "under freedom to provide services" may imply some limitation, perhaps to the type of activities envisaged by the Solvency II Directive itself, but it is not possible to be certain that such a limitation would be inferred, as it could equally mean any services within the scope of the Treaty on the Functioning of the European Union.

3.7.6. More can be inferred from the definition of "host Member State"[18] in the Solvency II Directive, which is defined as:

> "*the Member State, other than the home Member State, in which an insurance or a reinsurance undertaking has a branch or provides services; for life and non-life insurance, the Member State of the provisions of services means, respectively, the Member State of the commitment or the Member State in which the risk is situated, where that commitment or risk is covered by an insurance undertaking or a branch situated in another Member State;*"

3.7.7. As a result of this definition, it seems clear that there will be a Host Member State, and therefore a need to activate the passporting process, wherever the Member State of the

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[18] In the Directive "home" and "host" are not capitalised.

commitment (for life insurance) or the Member State where the risk is situated (for non-life insurance) is a different Member State from the Home Member State, irrespective of where the underwriting or claims payment or other activities are carried out.

3.7.8. "Member State of the commitment" is defined as:

> "*the Member State in which either of the following is situated:*
> *(a) the habitual residence of the policy holder;*
> *(b) if the policy holder is a legal person, that policy holder's establishment, to which the contract relates;*"

3.7.9. "Member State in which the risk is situated" is defined as:

> "*any of the following:*
> *(a) the Member State in which the property is situated, where the insurance relates either to buildings or to buildings and their contents, in so far as the contents are covered by the same insurance policy;*
> *(b) the Member State of registration, where the insurance relates to vehicles of any type;*
> *(c) the Member State where the policy holder took out the policy in the case of policies of a duration of four months or less covering travel or holiday risks, whatever the class concerned;*
> *(d) in all cases not explicitly covered by points (a), (b) or (c), the Member State in which either of the following is situated:*
> *(i) the habitual residence of the policy holder; or*
> *(ii) if the policy holder is a legal person, that policy holder's establishment to which the contract relates;*"

3.7.10. (Re)insurance can be carried on in such a way that it does not create a Host Member State within the above definitions, and does not amount to pursuing business "in" another Member State. For example, a motor insurance policy provided by a German insurer could cover a car registered in Germany even when it was in the UK, and the German insurer would not need to go through a passporting process provided that it did not enter the UK, even on a temporary basis, for the purposes of selling the policy or paying claims.

3.7.11. However, it would not necessarily follow that the German insurer would not be "effecting" or "carrying out" contracts of insurance in the UK by entering into the contract or performing its obligations under it – for example, by paying a claim to the policyholder while he is in the UK. This highlights an important distinction between:

(a) whether the (re)insurer would need to use the passporting process to do business that is connected in some way with another Member State (a matter mainly determined by Solvency II); and

(b) whether the (re)insurer would be regarded as carrying out insurance activities in another Member State (a matter mainly determined by the national law of that other Member State, but including its provisions implementing the Solvency II rules on passporting).

3.7.12. While this distinction is not always clear, what is clear is that if the EEA (re)insurer complies with the passporting process, it will be regarded as acting lawfully for both purposes.

3.7.13. Therefore, in most cases (re)insurers would be well advised to err on the side of caution by following the passporting process. As explained above, this is a relatively simple process. By following it, the (re)insurer will avoid the risk that it is subsequently found to have carried on activities in the Host Member State without authorisation.

3.7.14. Moreover, where a (re)insurer does have a permanent presence in the Host Member State, it may be difficult for it to argue that the activities of the presence are not (re)insurance activities and therefore do not require an establishment passporting notification. As noted in paragraph 3.4 above, the definition of "branch" that applies to passporting by EEA insurers (comprised of Article 13(11) as supplemented by Article 145) contains no requirement that the branch "pursues insurance activities" – in this respect it is different from the definition of "branch" that applies under Article 162 for non-EEA (re)insurers, which does include this requirement. Merely having a permanent presence of any kind would appear to be sufficient to require an establishment passporting notification.

3.7.15. It is instructive to contrast this analysis with the position of a (re)insurer incorporated outside the EEA which does not have a branch or authorisation inside the EEA. Can such a (re)insurer effect contracts of insurance covering commitments or risks in EEA Member States? What activities can it carry out in the EEA without having to establish a branch or obtain an authorisation? It is notable that in this situation Article 147 and the definition of "Host Member State", and related definitions, are not applicable. In addition, the definition of "branch" in Article 162 differs from the definition that applies to passporting.

3.7.16. These questions, as regards the UK, are addressed in detail in Chapter 5 but, in summary, there does appear to be a distinction between (a) what an EEA-authorised (re)insurer may do in another Member State of the EEA without going through a passporting process, and (b) what a non-EEA (re)insurer may do in an EEA Member State without going through an authorisation process.

CHAPTER 4

CONSEQUENCES OF THE DIFFERENT TREATMENTS

4.1. This Chapter describes some important legal and regulatory consequences of a (re)insurer providing cross-border services and a (re)insurer having an establishment in a Member State. In other words, why does this distinction matter from a legal and regulatory perspective? Some of these points are also addressed in other chapters.

4.2. It has already been noted in Chapter 3 that, within the EEA, the procedure and conditions for insurers (but not reinsurers) exercising passporting rights under national legislation implementing the Solvency II Directive differ according to whether freedom of services or freedom of establishment passporting rights are exercised. Failure to use the correct passporting procedure has the potential to result in the relevant (re)insurer acting unlawfully in the host Member State, or at least in breach of local regulatory requirements with the possibility of sanction by the Host State regulator.[19] It is therefore necessary to understand, so far as possible, which regime is relevant to the insurer's activities in that Member State.

4.3. There are a number of other potential consequences of the characterisation of an (re)insurer's activities as amounting to an establishment or services, including the following:

a) **More onerous passporting procedure**: As well as a longer notification timetable, an insurer which wishes to passport on a freedom of establishment basis is required to provide more information as part of its notification. This includes, for example, a scheme of operations.[20] Under some circumstances the Home Member State regulator may decline to authorise the establishment.

b) **Possibility of avoiding regulated activities altogether**: As noted in Chapter 3 and Chapter 7, it is in principle possible to organise certain non-domestic (re)insurance business, at least in so far as UK law applies, so that it does not involve the carrying on of regulated activities at all in the Host Member State. This will clearly not be the case where there is an establishment of the relevant (re)insurer in the Host Member State.

c) **Fundamental difference between treatment of EEA and 'third country' insurers**: EEA passporting rights mean that there is currently a fundamental difference between the treatment of EEA (re)insurers and non-EEA ('third country') (re)insurers

[19] In the UK, however, an EEA insurer that qualifies to carry on regulated insurance activities in the UK using a cross-border services passport would seem not to commit a criminal offence by establishing a branch instead. See paragraph 5.1.7 of Chapter 5.
[20] Article 145(2)(b) of the Solvency II directive.

in the UK. The former may exercise their passporting rights by making an appropriate submission to their Home Member State regulator. Experience suggests that, in relation to cross-border services, this is often done on a precautionary basis. Once the EEA insurer has qualified for these rights, there should be no risk of it committing a criminal offence by effecting or carrying out contracts of insurance in the UK while unauthorised. The position of third country insurers in the UK is quite different: with no EEA passporting rights, they risk committing a criminal offence (and of not being permitted to enforce relevant insurance policies) if they carry on these activities in the UK, whether on a cross-border services basis or from a UK establishment, without authorisation.

d) **Conduct of business rules**: Different conduct of business rules apply. For example, in the UK the table in Annex 1G to Chapter 13A of the FCA's Supervision Manual compares the application of FCA rules to incoming EEA firms (other than EEA pure reinsurers) with respect to activities carried on from a UK establishment and activities carried on other than from an establishment (ie, on a cross-border services basis into the UK). In particular, most of the rules in the FCA's Insurance: Conduct of Business sourcebook apply to an EEA insurer that carries on business from an establishment in the UK but most of those rules do not apply to an EEA insurer that carries on regulated insurance activities on a cross-border services basis into the UK.

e) **Jurisdiction of home state regulator**: Under the Solvency II Directive, the jurisdiction of Home Member State regulators varies according to whether there is an establishment of an EEA insurer in the relevant Host Member State. For example, Home Member State regulators may, having informed the relevant Host Member State regulator, carry out on-site inspections of an establishment of the insurer in that Host Member State (Article 33 of the Solvency II Directive).

f) **Reinsurance portfolio transfers**: Where reinsurance business is carried on through an establishment in an EEA Member State by an EEA reinsurer pursuant to its passporting rights, it may be possible to transfer the reinsurance business to another suitable body under the Host Member State's law on reinsurance portfolio transfers, even though the reinsurer's head office is not in that host state. See in particular section 105(2)(b) of the UK Financial Services and Markets Act 2000 (as amended), which allows such transfers in the UK.

g) **Financial Ombudsman Service ("FOS")**: In the UK the compulsory jurisdiction of the FOS applies to activities that are carried on by an insurer through an establishment in the United Kingdom.[21] The compulsory jurisdiction therefore applies to an EEA insurer which operates through an establishment in the United Kingdom, but not to an EEA insurer which operates on a freedom of services basis. EEA insurers which operate on a freedom of services basis may opt in to the

[21] DISP 2.6.1, forming part of the FCA rules.

voluntary jurisdiction of the FOS where the relevant insurance contracts are governed by the law of part of the UK and they notify the appropriate regulator in their Home Member State.

h) **Tax and companies legislation**: While local concepts of permanent establishments and branches under tax and companies legislation respectively differ from the concept of an establishment in EU insurance legislation, there are good reasons to consider these points together. For example, a (re)insurer's presence in a Member State is considered to be a branch for the purposes of legislation and rules implementing the Solvency II Directive may likewise be considered a branch for tax purposes.

4.4. At the time of writing, it remains unclear what provision will be made in UK law and regulation for EEA (re)insurers who effect or carry out contracts of (re)insurance in the UK in reliance on EEA passporting rights when the UK leaves the European Union. To the extent that such provision distinguishes EEA insurers that currently rely on the 'establishment' and the 'services' EEA passporting rights, it may be important for those (re)insurers to understand whether or not they have an establishment in the UK.

4.5. Where an insurance intermediary is involved in the origination or administration of (re)insurance business, the presence of that intermediary in the jurisdiction concerned can, as posited in the Interpretative Communication, result in the insurer to which that intermediary introduces (or on behalf of which the intermediary writes) business having an establishment in the jurisdiction. For the reasons mentioned in paragraph 4.3 above, it is likely to be of great importance to the (re)insurer to understand whether this will be the case. This may also affect the relationship that the (re)insurer and the intermediary should seek to agree between themselves.

CHAPTER 5

CURRENT UK LAW

5.1. THE UK REGULATORY FRAMEWORK

5.1.1. The UK financial services regulatory regime is governed by the Financial Services and Markets Act 2000 ("**FSMA**"), which provides that it is an offence to carry on a "regulated activity" by way of business in the UK unless authorised or exempt. This is referred to as the "general prohibition" and breach of it can result in a fine (unlimited) and prison sentences for individuals of up to two years.[22] A further consequence is that contracts entered into in breach of the general prohibition are unenforceable by the person who, by entering into them, was carrying on regulated activities without being an authorised person and without being an exempt person.[23]

5.1.2. The "regulated activities" falling within the FSMA regime are contained in the Financial Services and Markets Act 2000 (Regulated Activities) Order 2001/544 ("**RAO**"). Two regulated activities are relevant to (re)insurers:

(a) the activity of "effecting contracts of insurance"; and

(b) the activity of "carrying out contracts of insurance".[24]

5.1.3. The exact nature of these activities is considered in more detail in Chapter 7, in the context of non-EEA firms operating in the UK, where it is more significant. For purposes of this chapter, we assume that these activities are being carried on by an EEA firm in the UK, and we consider the law and regulation that applies as a result.

5.1.4. The activities of effecting and carrying out contracts of insurance in the UK are subject to regulation regardless of the location of the underlying policyholders or risks. Accordingly, an overseas insurer may be subject to regulation by the UK authorities with respect to UK operations, even where its policyholders are wholly outside the UK.

5.1.5. In the UK, (re)insurers are authorised by the Prudential Regulation Authority ("**PRA**") and regulated by both the PRA and the Financial Conduct Authority ("**FCA**"). FSMA empowers these regulators to make regulatory rules to govern firms which carry on regulated activities in the UK. In some cases, these rules apply only to firms authorised by the PRA in the UK, but in many cases they also apply to EEA firms who are passporting into the UK. As noted in Chapter 3, there are some rules whose application

[22] FSMA, sections 19 and 23.
[23] FSMA, section 26.
[24] Article 10 RAO.

to an EEA firm depends on whether it is passporting on a freedom of establishment or a freedom of services basis.

5.1.6. Schedule 3 to FSMA contains provisions which incorporate into UK law the passporting rules described in Chapter 3. This includes the requirements for notification and the applicable time periods. The FCA has issued guidance which explains the process in more detail – see Chapter 13 of the Supervision Manual. This guidance also explains the implications of the FCA rules for EEA firms who use passporting rights.

5.1.7. An EEA insurer which exercises passporting rights under Schedule 3 is deemed to be an authorised person under FSMA.[25] Accordingly, provided it has followed *one* of the applicable processes, it will be an authorised person, even if it later turns out that it has mistakenly followed the wrong passporting approach – for example, because it has followed the approach to passport on a cross-border services basis but is actually determined to be operating through an establishment. In this example, the EEA insurer would not be in breach of the general prohibition under FSMA, and agreements entered into by it would be enforceable, notwithstanding the mistake.[26]

5.1.8. This is an important observation because it means that the worst possible consequences (criminal liability and unenforceability of contracts) are not applied to a case where a mistake has been made as regards whether an insurer should be passporting on a cross-border services basis or an establishment basis.

5.1.9. Nevertheless, for the other reasons given in Chapter 4, it remains important that insurers know which is the correct basis. In particular, under section 20(1A) of FSMA, acting on the wrong passporting basis would mean that the EEA insurer would be "taken to have contravened a requirement imposed by the FCA and a requirement imposed by the PRA". This would make the EEA insurer liable to disciplinary action by the FCA or the PRA under Part XIV of FSMA. Taken together with the power of intervention in section 196, this could result in public censure, a financial penalty, or the imposition of a specific requirement prohibiting the EEA insurer from continuing to carry on certain activities in the UK.

Gibraltar

5.1.10. Under Article 355(3) of the Treaty on the Functioning of the European Union, the provisions of the EU Treaties apply to the European territories for whose external relations a Member State is responsible. By a declaration made by the UK and Spain in 2007, Gibraltar is expressly stated to be such a territory. Accordingly, Gibraltar is part of the EU by reason of this Article and declaration.

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[25] Section 31

[26] This is expressly provided in FSMA, section 20(2)).

5.1.11. In addition, Gibraltar is a part of the EEA by reason of the UK's membership of the EU. However, Gibraltar is not a separate EEA state from the UK, so by passporting into the UK, a Gibraltar (re)insurer would not be exercising an "EEA right" to be established or to provide services in an "EEA State other than that in which he has his relevant office" so as to satisfy the definition used in paragraph 7 of Schedule 3 to FSMA. Similarly, a UK (re)insurer passporting into Gibraltar would not be exercising an "EEA right" to be established or to provide services in an "EEA State other than that in which he has his relevant office". To address this concern, the UK Parliament passed the Financial Services and Markets Act 2000 (Gibraltar) Order 2001 in order to make clear that passporting rights exist as between the UK and Gibraltar.

5.2. **FCA GUIDANCE**

5.2.1. The FCA has published guidance on passporting activities in Appendix 3 to its Supervision Manual. This guidance concerns passporting by several types of financial services firms, not only insurers. It contains the following passages which are of interest to the Issue:

> *"**SUP App 3.3.5**: In 2000, the European Commission published a further interpretative communication (Freedom to provide services and the general good in the insurance sector (2000/C43/03)). This allowed the European Commission to publicise its own interpretation of the rules on the freedom to provide services.*
>
> …
>
> ***SUP App 3.3.7**: In giving its views, communications made by the European Commission have the status of guidance and are not binding on the national courts of EEA States. This is because it is the European Court of Justice that has ultimate responsibility for interpreting the Treaty and secondary legislation. Accordingly, the communications "do not prejudge the interpretation that the Court of Justice ..., which is responsible in the final instance for interpreting the Treaty and secondary legislation, might place on the matter at issue." (European Commission interpretative communication: Freedom to provide services and the general good in the insurance sector (C(99) 5046). However, the Courts may take account of European Commission communications when interpreting the Treaty and secondary legislation.*
>
> ***SUP App 3.3.8**: Firms should also note that European Commission communications do not necessarily represent the views taken by all EEA States.*
>
> …
>
> *"**SUP App 3.6.2**: Under the Treaty, the freedom to provide services within the EC may be exercised in three broad ways:*

(1) where the provider of a service moves temporarily to another EEA State in order to provide the service;

(2) where the service is provided without either the provider or the recipient moving (in this situation the provision, and receipt, of the service may take place by post, telephone or fax, through computer terminals or by other means of remote control);

(3) where the recipient of a service moves temporarily to another EEA State in order to receive (or, perhaps, commission the receipt of) the service within that State.

SUP App 3.6.3*: Under the Single Market Directives, however, EEA rights for the provision of services are concerned only with services provided in one of the ways referred to in SUP App 3.6.2 G (1) and (2).*

…

SUP App 3.6.6*: An insurance undertaking that effects contracts of insurance covering risks or commitments situated in another EEA State should comply with the notification procedures for the provision of services within that EEA State. The location of risks and commitments is found by reference to the rules set out in paragraph 6 of schedule 12 to the Act, which derive from article 13(13) and (14) of the Solvency II Directive. It may be appropriate for insurers to take legal advice as to how these rules are interpreted and applied in other EEA States. The need to passport may arise because of only one of the risks covered by an insurance policy. This includes, for example, where a policy covers a number of property risks and one of those properties is in another EEA State.*

…

SUP App 3.6.11*: The key distinction in relation to temporary activities is whether a firm should make its notification under the freedom of establishment in a Host State, or whether it should notify under the freedom to provide services into a Host State. It would be inappropriate to discuss such a complex issue in guidance of this nature. It is recommended that, where a firm is unclear on the distinction, it should seek appropriate advice. In either case, where a firm is carrying on activities in another EEA State under a Single Market Directive, it should make a notification.*

5.2.2. We would make a number of observations on this guidance:

- The FCA refers to the existence of the Interpretive Communication, but stresses its non-binding nature. It also avoids reciting any of the content of the Interpretive Communication. This is in contrast to the approach it adopts to a similar interpretive communication published by the European

Commission in 1997 which concerns passporting by banks, where it specifically endorses the view expressed by the Commission.[27]

- The guidance in SUP App 3.6.6 appears to say that the question of whether a passporting notice is required depends purely on where the risks or commitments covered by the contract are "situated", rather than where the activity of entering into the contract is carried on. This is consistent with the definition of "host member state" in the Solvency II Directive – see paragraph 3.7.5 et seq. of Chapter 3 above. However, it would seem to be in conflict with the guidance in SUP App 3.6.3 where the FCA states that EEA passporting rights are not concerned with the scenario where the policyholder moves temporarily to another EEA State in order to receive insurance within that State. The implication of SUP App 3.6.6 is that if a potential policyholder habitually resident in France travelled to the UK and purchased insurance from an insurer in the UK, the UK insurer would need to have at least a freedom of services passport with respect to France.

- The FCA guidance uses some terms slightly loosely. For example, SUP App 3.6.2 uses the term "freedom to provide services" in a way that is clearly meant to cover both freedom of services and freedom of establishment. In addition, in SUP App 3.6.11 it refers to "temporary activities", with the implication that temporary activities are covered by a freedom of services passport and permanent activities are covered by a freedom of establishment passport. This seems to be an over-simplification. In particular, there is no reference to the scenario where a (re)insurer that itself carries on no activities in the Host Member State relies upon activities of a third party intermediary that is permanently based in the Host Member State.

- Most significantly for the purposes of this paper, in SUP APP 3.6.11 the FCA notes the difficulty of deciding whether to make a freedom of services notification or a freedom of establishment notification. It states that it would be inappropriate to discuss "such a complex issue" in its guidance, and advises firms who are unclear on the distinction to seek appropriate advice. This underlines the difficulty in this area. Advisers often consider it appropriate to seek assistance from published regulatory guidance!

5.3. PRA GUIDANCE

5.3.1. In January 2016 the PRA published a "frequently asked questions" document relating to passporting.[28] This contains the following passage:

[27] See SUP App 3.6.8.

[28] See http://www.bankofengland.co.uk/pra/Documents/authorisations/passporting/passportingfaqs.pdf (page accessed 14 May 2017).

"***How do I know whether an establishment or cross-border services passport is needed?***

The firm would need to apply for an establishment passport if intends to hold a physical presence within the host state.

If the services are provided on a temporary basis (by remote means such as through the internet) and the recipient moves to another EEA state to receive the services, then this suggests a cross-border services arrangement and so a cross-border services passport is required."

5.3.2. This document has been published as a practical guide rather than as formal rules and guidance of the PRA, and it does not form part of the PRA Rulebook. It is therefore not surprising that it does not go into detail about the complications addressed in this paper regarding the use of a third party intermediary who is permanently based in the another EEA state.

5.3.3. Nevertheless, the absence of guidance on this issue, taken together with the FCA's quite limited guidance, and the FCA's emphasis that the Interpretive Communication does not necessarily represent the law, leaves doubt about whether the UK regulators agree with the Interpretive Communication.

5.4. **CASE LAW**

5.4.1. There has been no case law in the UK addressing the question of when an (re)insurer is required to make a passporting notification on an establishment basis and when it is required to make the notification on a services basis.

5.4.2. There has been case law on the question of what activities constitute the regulated activities of "effecting" and "carrying out" contracts of insurance in the UK. This case law is summarised in Chapter 7, as it has primarily been relevant to the question of what a non-EEA entity can do in the UK without any authorisation.

5.4.3. Depending on the interpretation of the definition of "branch" in the Solvency II Directive, the case law could in theory be helpful in the passporting context if the non-UK (re)insurer actually had a permanent presence in the UK, and carried on certain activities from that permanent presence and certain other activities directly from its Home Member State. The case law could be applied to assess whether the UK activities constituted carrying on (re)insurance business from the UK presence, in which case an establishment passporting notification would be required, or whether the UK activities were merely ancillary, so that the (re)insurance activities could be regarded as being cross-border services, so that only a cross border services passporting notification would

be required. The case law could therefore useful in analysing Scenario 3 considered in this paper.

5.4.4. However, as noted in Chapter 3, the definition of "branch" in Article 13(11) of the Solvency II Directive, as supplemented by Article 145, contains no reference to the need for the permanent presence or agency of the (re)insurer to "pursue insurance business" – unlike Article 162, which applies where a branch of a non-EEA insurer is being established. It therefore appears that a non-UK EEA (re)insurer which has a permanent presence in the UK could not safely rely on the above case law to argue that the activities of that permanent presence are entirely non-insurance activities, and thereby justify relying only on a services passporting notification. If that is correct then the case law does not assist even in the analysis of Scenario 3.

5.4.5. The UK case law does assist the analysis in Scenario 4, since that Scenario concerns a non-EEA (re)insurer to which the definition of "branch" in Article 162 applies.

5.4.6. Moreover, if it is accepted that all of the relevant activities are actually (re)insurance activities, and the question is instead whether the non-UK (re)insurer is carrying them on through a physical presence of the non-UK (re)insurer in the UK (which is the main focus of this paper), the case law is not useful. This is true of Scenarios 1 and 2 considered in this paper, where is clear that (re)insurance activities are being carried on in the UK.

5.5. DOES THE INTERPRETIVE COMMUNICATION REPRESENT THE LAW IN THE UK ?

5.5.1. As noted in paragraph 3.6.13 et seq. of Chapter 3, there is a substantial question whether the Interpretive Communication has now been superseded by the definition in Article 145(1) of the Solvency II Directive, and in particular whether the "direction and control" requirement still applies.

5.5.2. Our view is that, notwithstanding Article 145(1), the UK courts would still regard themselves as bound by the case law that underpinned the views set out in the Interpretive Communication. Article 145(1) is written in general terms and in principle follows the same direction as the Interpretive Communication, in clearly adopting two parts of its three part test. This suggests that the EU was taking the Interpretive Communication into account and attempting to summarise it, rather than to depart from it. If it had intended to change the law by removing the "direction and control" part of the test then we would have expected it to include a specific reference to that intention, with words such as "whether or not subject to the direction and control of the (re)insurer."

5.5.3. We also note that the FCA guidance in the Supervision Manual still contains reference to the Interpretive Communication (albeit without wholeheartedly embracing it), with no qualification by reference to Article 145(1), and the PRA guidance is silent on both.

5.5.4. Therefore, while there is no certainty on the point, we would regard the Interpretive Communication as representing the law in the UK.

5.6. ANALYSIS OF SCENARIOS

5.6.1. We now consider how the UK law would be applied in the four Scenarios that were set out in Chapter 1. As noted in section 5.5 above, we work on the assumption that the Interpretive Communication does still represent the law, although there is uncertainty about this point.

Scenario 1

5.6.2. To analyse this scenario, we consider the three cumulative conditions set out in the Interpretive Communication.

5.6.3. First: is D "subject to direction and control of the insurer"?

- If D is subject to an exclusive brief from ABC alone then this will be a relevant factor suggesting that it is indeed subject to the direction and control of ABC. However, the mere fact that D also carries out work for other insurers DEF and GHI will not of itself preclude its being subject to the direction and control of ABC if D nevertheless has an exclusive brief from ABC in relation to the activities relevant to ABC's business.

- The existence of a controlling shareholding by ABC in the capital of D, including where D is a subsidiary, will be indicative that the insurer controls that person and that this condition may be fulfilled as a result. The position is less clear where D is merely an affiliate of the insurer. It would be a question of fact as to whether the surrounding circumstances suggest that the insurer controls D. However, in a case where the independent person and the insurer have common directors this would probably indicate that the criterion of control is met.

- We note that in most cases, it seems likely that control rights would be documented, which would suffice irrespective of the group structure.

5.6.4. Second: is D "able to commit the insurer"?

- This criterion would likely be satisfied simply by virtue of the underwriting authority. The fact that the underwriting guidelines may be amended at ABC's request and that

the authority is limited to $10m will not change the analysis provided that D can indeed commit ABC vis-à-vis third parties where it acts within the scope of its authority.

5.6.5. Third: has D "received a permanent brief"?

- The Commission's view is that in order to fall within the rules concerning right of establishment, the independent person must be the subject of a "long-term, continuous brief and not a brief that is limited in time or a one-off instruction". In the present scenario, if the agreement is for an indefinite period then the criterion will likely be satisfied notwithstanding that it is terminable upon 6 months' notice.

- If the agreement is limited to three years then it is clearly limited in time and so on the basis of the arguments set out in the Interpretive Communication this would not constitute a permanent brief and would fall within freedom to provide services. However, it is questionable whether three years would be considered "long term" or, if it would not, whether five years or ten years would be.

- In any event, in the absence of more definitive law, it would be unsafe for a (re)insurer to assume there is no establishment merely because the independent person's brief contains a termination date, or a termination right.

Scenario 2

5.6.6. We consider the three cumulative criteria set out in the Interpretive Communication, as before.

5.6.7. First: is D "subject to direction and control of the insurer"?

- This would depend on the agreements in place between D and the insurer, as supplemented by any capital and or other links (for example, common directors) between D and the insurer. See the analysis for Scenario 1 above.

5.6.8. Second: is D "able to commit the insurer"?

- This would be met simply because of the underwriting authority (regardless of the underwriting guidelines). See the analysis for Scenario 1 above.

5.6.9. Third: has D "received a permanent brief"?

- As for Scenario 1, the relevant criteria would be whether D's appointment is based on a long-term (continuous brief) or whether the brief is limited in time or a one-off instruction.

Scenario 3

5.6.10. A liaison office of the type described in Scenario 3 would probably not satisfy the three cumulative conditions set out in the Interpretive Communication on the basis that the local staff are not able to bind the undertaking and, therefore, the liaison office would not satisfy the second condition. However, the position is not entirely clear cut and in this scenario ABC would run the risk that it may blur the lines between providing cross-border services and having a permanent establishment - for example, if the activities of the staff have the effect in practice of binding ABC, even though legally there is no authority conferred on them.

5.6.11. Nevertheless, since the liaison office is a permanent establishment of ABC in the UK, it is a “branch” within the meaning of Articles 13(11) and 145 of the Solvency II Directive. Therefore, even if the conclusion can be reached that the activities of the liaison office are not “(re)insurance activities” (on the basis that there is no negotiation with policyholders and no underwriting decisions are made in the UK), it would follow from a literal interpretation of the Solvency II Directive that an establishment passporting notification would be required.

Scenario 4

5.6.12. If ABC were considered to be acting through a branch it would have to establish a local branch in the applicable jurisdiction which is authorised by the Member State in accordance with Article 162 of the Solvency II Directive.

5.6.13. There is a question whether ABC's activities, and the activities of the persons acting on its behalf, could be considered to be so minor that they would not constitute any part of the negotiation or performance of the policies written. The UK case law on what activities constitute carrying on insurance business, summarised in Chapter 7, is relevant to this question, since the definition of “branch” in Article 162 refers to the branch “pursuing insurance business”.

5.6.14. In Scenarios 1 and 2, we would not consider this would be the case, given the direct negotiation with policyholders on behalf of ABC (in Scenario 1) and X, Y and Z (in Scenario 2), whatever the level of independence of the underwriting agent or broker, and however temporary and non-exclusive its appointment. Therefore, a branch authorisation would need to be made under Article 162.

5.6.15. However, if it were clear that the underwriting agent or broker were not actually acting on behalf of ABC, but was merely acting as an independent intermediary, or was acting on behalf of the policyholder rather than the (re)insurer, then it might be that no such authorisation would be required. This situation arises often in practice, and therefore considerable weight is being placed on the distinction between the two approaches.

5.6.16. In Scenario 3, we consider that the liaison office would not amount to carrying on business in the EEA, so no branch authorisation would be needed. It is notable that in this situation it appears that a non-EEA (re)insurer would not need an authorisation of any kind, but an EEA (re)insurer wishing to do the same thing would be likely to need to go through a passporting notification process on a freedom of establishment basis.

5.6.17. The above analysis represents the working group's interpretation of the application of UK law. However, it should be noted that Article 162 is capable of a wide reading as it refers to the need for a branch and an authorisation being a condition of "access to the business" of direct insurance in EEA Member States. The European Commission has indicated in a minuted meeting that it regards this Article as having a wide meaning – please see the discussion of this issue in paragraphs 7.2.4 et seq. of Chapter 7.

CHAPTER 6
APPLICABLE REGIME IN OTHER EEA MEMBER STATES

6.1. INTRODUCTION

6.1.1. In practice, the position across the EEA Member States which we have surveyed - being France, Germany, Italy, the Netherlands, Poland and Spain (the "**Jurisdictions**") - is similar to the position under Solvency II, as described in Chapter 3. The basic position is set out in Article 145(1) (¶2) of the Directive, which sets out notification requirements applicable to establishment of either a "branch"[29] or "any permanent presence of an undertaking in the territory of a Member State" which is treated as a branch "even where that presence does not take the form of a branch, but consists merely of an office managed by their own staff of the undertaking or by a person who is independent but has permanent authority to act for the undertaking as an agency would".

6.1.2. As such, an insurer may be deemed to be "established" and will therefore be required to exercise its Freedom of Establishment ("**FoE**") passporting right, without necessarily operating in the relevant Host EEA Member State from a physical branch of its own. There is no one common definitive test across the Jurisdictions, in determining whether an insurer is deemed to be "established". Some Jurisdictions have adopted positions that appear to differ from the Interpretative Communication, in that the "direction and control" criterion has not been specifically adopted. Nevertheless, if challenged on this point, the regulators in the relevant Jurisdictions may well have regard to the Interpretive Communication.

6.2. APPLICABLE REGIME IN OTHER MEMBER STATES

6.2.1. Italy, the Netherlands, Poland and Spain do not have local laws or guidelines on the issue, and have not expressly indicated that the Interpretative Communication would be persuasive in determining whether an insurer would be deemed to be established in their jurisdiction. In the absence of local laws, regulation or guidance, the view is that the Interpretative Communication is not necessarily binding on the local regulator.

6.2.2. Article 145 of the Directive is authoritative in each of the Jurisdictions and as such both "permanent presence" and "permanent authority" feature in the local law definition of a "branch", introducing two of the Interpretative Communication criteria into the definition. As the Interpretative Communication is not legally binding, it is merely persuasive in the local law interpretation of Article 145. Therefore, with respect to the third criteria of "direction and control", it is unclear to what extent it is introduced into local law in the absence of any guidance on the Interpretative Communication. Germany

[29] A "branch" is defined in article 13(11) of the Directive, in somewhat circular fashion, as "an agency or a branch of an insurance or reinsurance undertaking which is located in the territory of a Member State other than the home Member State".

has published guidelines on the Issue, but similarly does not appear to include the direction and control criteria.

6.2.3. If an insurance undertaking is deemed established in any Host Member State, it would be required to notify its Home Member State regulator in order to exercise its freedom of establishment passport to conduct its activities in the EEA Member State through an establishment. The "establishment" of the insurance undertaking is then also likely to need to comply with local corporate and tax branch registration requirements, although there does not appear to be a direct legal link between a regulatory establishment and a corporate establishment or branch.

6.3. POSITION IN FRANCE, GERMANY, ITALY, NETHERLANDS, SPAIN AND POLAND

6.3.1. We have surveyed the Jurisdictions on the applicable regime locally and how they would expect the Scenarios to be interpreted in their jurisdictions, if in each case the relevant Jurisdiction is the Host Jurisdiction and the Home Jurisdiction is another EEA Member State (or, in Scenario 4, Japan).

France

6.3.2. The French Insurance Code (*Code des Assurances*) does not specifically incorporate the language in article 145(1) (¶2) of the Solvency II Directive and to our knowledge the, French regulator (the *Autorité de Controle Prudentiel et de Résolution* or ACPR) has not issued any guidance dealing specifically with the questions raised by the Scenarios.

6.3.3. The Insurance Code sets out formalistic requirements for a branch established under passport rights: first, the branch must operate under the supervision of a general manager (*mandataire général*) who is either an individual domiciled and resident in France meeting "fit and proper" requirements (*exigences de competence et honorabilité*) applicable to insurance executives generally, or a company having its seat in France which itself is managed by such an individual (see Insurance Code, articles L.362-1 and R.362-2); and second, the French regulator (the *Autorité de Controle Prudentiel et de Résolution* or ACPR) must have received, from the home-country regulator, various information including a scheme of operations for its business to be carried out in France (Insurance Code, articles L.362-1 and A.362-1 I).

6.3.4. It should also be noted that the Insurance Code restricts the categories of insurance intermediaries having binding authority to write business on behalf of an insurer to those which are registered as either managing general agents (*agents généraux d'assurance*) or managing general underwriters (*mandataires d'assurance*, which are allowed to have binding authority only for coverage of certain maritime, rail and air transport risks).

6.3.5. Considering these factors (and based on informal exchanges on this subject with the ACPR), arrangements such as those described in Scenarios 1, 2 and 3 might well not be regarded by the ACPR as a branch, assuming that the insurers in each case have made

the appropriate notification required to conduct business in France on a freedom-of-services basis.. However, some sources suggest a different conclusion, and it cannot be excluded that the ACPR would take a different view if it considered that the arrangements put in place were subject to the direction of the non-French insurer and constituted the functional equivalent of a branch, in particular if in scenario 3 the activities involved underwriting and not just representational functions.

6.3.6. As for scenario 4, under which a third-country insurer (in this case, a Japanese insurer) is seeking to cover risks in France either through an intermediary with binding authority or by establishing a representational office, establishment of a licensed branch in France would be required, since the French Insurance Code prohibits coverage of any such risk (with some limited exceptions) except by French insurers, EEA insurers acting under freedom-of-services or freedom-of-establishment rules, French branches of Swiss insurers (for non-life business) and third-country insurers acting through a French branch licensed by the ACPR.

Germany

6.3.7. The German Insurance Supervision Act (Versicherungsaufsichtsgesetz, ("**VAG**")) sets out that a branch is deemed to exist if the insurance business is conducted by a person which is, although independent, instructed to conduct the insurance business on a permanent basis and from a permanent presence in the host state. Although this wording has been drafted against the backdrop of EU law, it does not repeat the definition used in the Interpretative Communication in its entirety.

6.3.7.1. The German Federal Financial Supervisory Authority (Bundesanstalt für Finanzdienstleistungsaufsicht, ("**BaFin**")) has published guidelines on "the activity in other states of the EU/EEA" (Hinweise für die Tätigkeit in den EU/EWR-Staaten (2010) "**Guidelines**"). In these Guidelines, BaFin distinguishes between insurance agents, as persons who are entrusted by the insurer to solicit or conclude insurance contracts on a commercial basis, and insurance brokers, as persons who assume the intermediation or conclusion of insurance contracts on a commercial basis without being entrusted to do so by an insurer or insurance intermediary.

6.3.7.2. BaFin states that, where insurance agents are involved in a Host State, a FoE permission is required whereas pure brokerage activities do not trigger this requirement. However, if a broker has the authority to settle claims on the insurer's behalf, the FoE requirement is likely to be triggered.

6.3.7.3. This wide interpretation of the FoE Requirement is disputed in German legal literature given that the first requirement under the Interpretative Communication regarding the direction and control of the agent, does not seem to be reflected in the German provisions. However, as noted in Chapter 3, it is arguable that by not restating the "direction and control" requirement, Article 145 of the Solvency II Directive has effectively removed this requirement.

Italy

6.3.8. The Italian Insurance Act states that insurance business pursued (i) out of branches or agencies of the insurance undertaking; or (ii) through any other permanent presence in Italy, must be continued as business *from* an establishment and therefore under the FoE regime. Business pursued under the second limb – "through any other permanent presence" – includes business conducted by a person who is independent but has permanent authority to act for the insurer.

6.3.9. Despite the Italian Insurance Act appearing to be wider than the Interpretative Communication in capturing when an insurer is deemed to be established by virtue of an agent, the better view seems to be that it should only apply where the independent person is subject to the direction and control of the insurance undertaking, in line with the Interpretative Communication.

The Netherlands

6.3.10. The Dutch Financial Supervision Act (the **Dutch FSA**) provides a definition of a branch which includes "any other permanent presence of an insurance company managed by employees of the insurer or by a person who has a permanent authority to act for the insurer". The explanatory notes to the Dutch FSA state that this definition clarifies that "authorised agents" (ie intermediaries with binding authority to underwrite one or more classes of business on behalf of one or more insurers, or to issue certificates of insurance on behalf of one or more insurers) shall be treated as a branch or establishment of the insurer. There is no specific explanation or guidance to confirm that the definition shall be restricted only to those authorised agents that are subject to the direction and control of the insurance undertaking.

6.3.11. Whilst the Dutch Central Bank (the "**DNB**") has not acknowledged the Interpretative Communication as a source of reference for interpreting the FoE requirement, the Interpretative Communication has been cited in Dutch legal literature as a source of reference for determining whether or not an insurer is established in The Netherlands when acting through an agent. Although the first requirement under the Interpretative Communication regarding the direction and control of the agent is not reflected in the Dutch provisions, that is not to say that the Interpretive Communication would not be persuasive on the DNB's approach.

Spain

6.3.12. Article 8.6 of Law 20/2015 on Ordination, Supervision and Surveillance of Insurance and Reinsurance Entities ("**LOSSEAR**") implements articles 13(11) and 145(1) (¶2) of Solvency II with the same wording, except for a slight difference: the LOSSEAR does not use the word "agent", as mentioned in both articles 13(11) and 145(2) of Solvency II, which is also included in the Spanish version of Solvency II. The LOSSEAR includes cases in which there is a deemed establishment where insurers act through "*a person who is independent but has permanent authority to act for the undertaking as **branch***". Whilst it may be argued that the use of the word "branch" instead of "agent" in the LOSSEAR suggests that the powers of the independent person must be wider than those of a typical agent,

the specific circumstances will need to be considered since according to CJEU case law, Spanish laws should be interpreted in light of EU law. The difference may have been due to the particularities of the Spanish market where, in addition to "agents", there are the so-called "underwriting agencies" which are not technically agents and can also be caught within the scope of article 8.6 of LOSSEAR.

6.3.13. The Spanish Insurance Regulator, the General Directorate for Insurance and Pension Funds ("**DGSFP**"), has not formally acknowledged that they rely on the Interpretative Communication. However, in the absence of Spanish laws on the matter, this does not mean that the DGSFP will not rely on the Interpretative Communication if they consider it appropriate to do so.

6.3.14. Since there are no specific guidelines or formal criteria as to when an insurance undertaking is established other than the general reference mentioned in article 8.6 of LOSSEAR, there is a similar lack of clarity in Spain as to the circumstances in which an intermediary holding a delegated authority will be treated as the insurance undertaking's establishment and when not.

Poland

6.3.15. The Polish Financial Supervision Authority (*Komisja Nadzoru Finansowego* ("**KNF**")) has not made any formal acknowledgements that it relies on the Interpretative Communication. In the absence of any formal acknowledgement, we would expect that the KNF is likely to rely on the Interpretative Communication when determining when an insurance undertaking is deemed to be established.

6.4. ANALYSIS OF THE SCENARIOS IN THE JURISDICTIONS

6.4.1. In the absence of local laws or guidelines on the matter, most jurisdictions (excluding Germany which has published its own guidelines), local counsel have based their analysis on their view of how the local regulator is likely to interpret the scenarios. It is possible that the local regulator may take a different view.

6.4.2. The positions taken by the Jurisdictions (other than France) in Scenario 1 is similar to the position in the UK. The three cumulative conditions need to be analysed for each factual scenario to determine whether a branch is deemed to be established. Similar to the position in the UK, and in the absence of any local laws of guidance, indicative factors that a person is under an insurance undertaking's direction and control include an exclusive brief and being in the same corporate group as the insurer. The Jurisdictions also take the view that the fact that a person also carries out work for other insurers does not preclude it being subject to the direction and control of the insurer. Similarly, a binding underwriting authority between an underwriting agent and an insurer is also indicative in the Jurisdictions that the underwriting agent is able to commit the insurer. A key difference in the interpretation of the conditions between the UK and the Jurisdictions is that in all the Jurisdictions, a contract expiring on 31 December 2019 could be seen as long term and continuous. The UK position is less clear as to whether continuous fixed term of three years would be treated as such.

6.4.3. Across all Jurisdictions (other than France), the position in Scenario 2 is similar to the position in the UK and the analysis as to whether a branch is deemed to be established through the presence of a broker the same as the analysis for Scenario 1. In all Jurisdictions including the UK, if the three cumulative conditions are met, it is likely that a branch is deemed established, regardless of whether the presence is through an "underwriting agent" or "broker".

6.4.4. The position in Scenario 3 differs across all Jurisdictions. The presence of staff in Italy, the Netherlands and Spain may be sufficient to trigger a FoE requirement. In the Netherlands, whether a FoE is required depends on whether the local staff have direct contact with policyholders and in Spain, the analysis is dependent on the location of the risk. In France a key factor is likely to be the extent to which the liaison office pursues specific business opportunities, beyond simply providing information and facilitating contact with the insurer's office in its home country. It is questionable whether the position in The Netherlands, Spain and France is consistent with the Solvency II Directive, given that the definition of "branch" in Article 13(11) and 145 does not refer to the branch having to be carrying on (re)insurance activities in order for the requirement for an establishment passporting notification to be made.

6.4.5. Where the insurer is incorporated in Japan and headquartered in Tokyo as envisaged in Scenario 4, the basic position is the same. Where the insurer is considered to be acting through a branch, there will be a requirement to establish a local licensed branch in all Jurisdictions. Similar to the UK, there exist some exceptions to the general position.

6.4.6. The table below sets out how each of the Jurisdictions would likely interpret their own laws and guidelines or the Interpretive Communication in each of the four Scenarios.

TABLE 1

ANALYSIS OF SCENARIOS IN THE JURISDICTIONS[30]

	France	Germany	Italy	Netherlands	Poland	Spain
Scenario 1	- FoE permission might not be required if ABC complies with French requirement for intermediaries and the insurer has made the required FOS notification.	- FoE permission required under German law guidelines. - Termination right does not affect permanent basis analysis.	- FoE permission likely required under analysis of the Interpretative Communication and Italian Insurance Act. - If no clear suggestion that D is fully subject to ABC's direction and control, no FoE permission required.	-FoE permission likely required under Dutch Financial Supervision Act definition. -If DNB relies on the Interpretative Communication, detailed examination of relationship required to determine whether D is subject to the direction and control of ABC.	- FoE permission may be required under analysis of the Interpretative Communication. - FoE permission likely required if D is given an exclusive brief.	- FoE permission may be required under analysis of the Interpretative Communication. - If no clear suggestion that D is fully subject to ABC's direction and control, no FoE permission required. - Exclusive brief can be an indication that D is fully subject to ABC's direction and control, especially if broad powers of attorney are granted
(a) D is also appointed as underwriting agent by insurers DEF and GHI on	- Does not affect the analysis (but it impacts the status of ABC as an intermediary).	- Does not affect analysis.	- May suggest that D is not subject to ABC's direction and control. If so, likely that no FoE permission is required.	- Does not affect analysis.	- Does not affect analysis.	- May suggest that D is not subject to ABC's direction and control.

[30] Please note that table below summarises the basic position in each Jurisdiction. A detailed examination of the facts will be required in all jurisdictions.

	France	Germany	Italy	Netherlands	Poland	Spain
the same terms						- Likely that no FoE permission is required.
(b) (i) D is in the same corporate group as ABC and is an affiliate /subsidiary of ABC	- Taken alone, probably does not affect the analysis.	- Does not affect analysis.	- May suggest that D is under the direction and control of ABC. -Detailed examination of relationship required. - FoE permission will most likely be required.	- Does not affect analysis.	- Does not affect analysis.	- May suggest that D is under the direction and control of ABC. - Likely that FoE permission is required.
(b)(i) D is in the same corporate group as ABC and has common directors with ABC	- Taken alone, probably does not affect the analysis.	- Does not affect analysis.	- May suggest that D is under the direction and control of ABC. -Detailed examination of relationship required. - FoE permission will most likely be required.	- Does not affect analysis.	- Does not affect analysis.	- May suggest that D is under the direction and control of ABC. - Likely that FoE permission is required.
(c) Fixed term contract expiring 31 December 2019	- Taken alone, probably does not affect the analysis.	- Does not affect analysis. -A fixed term of three years is likely to be considered a permanent brief.	- Does not affect analysis. -A fixed term of three years is likely to be considered a permanent brief.	- Does not affect analysis. -A fixed term of three years is likely to be considered as permanent authority to act.	- Does not affect analysis.	- Does not affect analysis.
Scenario 2	- FoE permission might not be required if D complies with French requirement for intermediaries and	- FoE permission required on the basis of the binding authority.	- Does not affect analysis from Scenario 1 above.	- Does not affect analysis.	- Does not affect analysis.	- Does not affect analysis.

	France	Germany	Italy	Netherlands	Poland	Spain
	the insurer has made the required FOS notification.					
Scenario 3	- FoE permission might not be required, if the activity of the liaison office is restricted to providing information and facilitating contact with the insurer's office in its home country	- No FoE permission required as long as the liaison office staff do not conclude contracts of insurance or settle claims on behalf of ABC. - For reinsurance business in a third EEA State, re(insurers) do not need to follow the passport procedure or meet certain organisational requirements to be permitted to conduct business in Germany.	- Presence of a local office in Italy with envisioned staff likely to trigger FoE permission requirement.	-Presence of a local office in the Netherlands with envisaged staff likely to trigger FoE permission requirement. -No FoE permission may be required if and for as long as the liaison office does not have direct contact with policyholders, based on DNB guidance.	- No FoE permission required as long as the liaison office does not perform insurance activity.	- Depends on location of risk. - If risk is located in Spain, presence of a local office in Spain with envisioned staff will likely trigger a FoE permission.

	France	Germany	Italy	Netherlands	Poland	Spain
Scenario 4 (a) analysis under Scenario 1 where ABC is incorporated in Japan	- ABC will be required to establish a licensed branch; note that the French insurance monopoly extends to any insurance of a French-situs risk (with exceptions including marine and air transport).	- ABC will most likely need to establish a licensed branch. - Restrictive exemption available where conclusion of contract is by way of correspondence without assistance from professional intermediary and where the German policyholder initiates the conclusion of the contract. - For reinsurance business, Japan has been granted equivalence by the European Commission and as such, ABC may conduct business in Germany directly from its head office without the requirement to establish a licensed branch in Germany.	- ABC will be required to establish a licensed branch.	- ABC will in principle be required to apply for a Dutch license for having a 'deemed branch' in the Netherlands (by having D acting as underwriting agent). - Even if ABC is deemed by the DNB as not having a branch in the Netherlands (and no Dutch license requirement would be triggered), ABC would still need to register with the DNB and would become subject to certain requirements, including requirements to be authorized as (re)insurer in Japan and to actually have a branch in Japan from which insurance activities are undertaken. ABC will also become subject to the Dutch solvency requirements (implementing Solvency II).	- ABC will be required to establish a licensed branch. - For reinsurance business, ABC may conduct business in Poland directly from its head office without the requirement to establish a licensed branch in Poland. - Business conducted from the head office will need to be distinguished from business conducted through a permanent presence in Poland.	- ABC will be required to establish a licensed branch for insurance activities. - For reinsurance activities, Spanish law allows third country reinsurers to carry out reinsurance activities without being authorised provided that the activity is being carried out from its home country and not from a branch in Spain. If a person (established in Spain) acting for the third party reinsurer is deemed to be included under the Interpretative Communication, a Spanish licensed branch of the reinsurer will likely be required.

	France	Germany	Italy	Netherlands	Poland	Spain
		- Business conducted from the head office will need to be distinguished from business conducted through a permanent presence in Germany.		- Japanese reinsurance companies are in principle exempt from any license and registration requirements in the Netherlands if they perform their reinsurance activities from a branch in Japan. This is on the basis of the Solvency II equivalence granted to Japan until 31 December 2020. However, this is only relevant if ABC does not engage in direct insurance business in the Netherlands. The scenario description suggests that ABC engages in direct insurance business.		
Scenario 4 (b) analysis under Scenario 3 where ABC is incorporated in Japan	- ABC would be required to establish a licensed branch if the liaison activity involves French-situs risks; note that the French insurance monopoly extends to any insurance of a French-situs risk (with exceptions	- ABC will most likely need to establish a licensed branch. - For reinsurance business, no licensed branch required as long as the liaison office staff do not conclude insurance contracts nor settle claims on behalf of ABC.	- ABC will be required to establish a licensed branch.	- ABC will in principle be required to establish a licensed branch. - Arguably, no license requirement may be triggered if and for as long as the liaison office does not have direct contact with policyholders, based on DNB guidance (see for Scenario 3 above).	- ABC will be required to establish a licensed branch. - For reinsurance activities see 4(a) above.	- ABC will be required to establish a licensed branch for insurance activities. - For reinsurance activities see 4(a) above.

	France	Germany	Italy	Netherlands	Poland	Spain
	including marine and air transport), so "reverse solicitation" does not allow coverage of such risks by a non-EEA insurer.			However, ABC would still need to register with the DNB and would become subject to certain requirements, including requirements to be authorized as (re)insurer in Japan and to actually have a branch in Japan from which insurance activities are undertaken. ABC will also become subject to the Dutch solvency requirements (implementing Solvency II). - For reinsurance activities see 4(a) above.		

CHAPTER 7
NON-EEA INSURERS

7.1. INTRODUCTION

7.1.1 If a non-EEA (re)insurer wishes to carry on regulated activities in the UK then it must be authorised in the UK. This means setting up a branch in the UK and applying for authorisation.

7.1.2 Determining whether authorisation is required in any particular instance is often a straightforward matter – it depends on exactly what functions will be performed in the UK. However, where the insurer performs relatively few of its functions in the UK, it is not always clear whether those functions may constitute regulated activities, and/or whether the extent of those activities is sufficient to mean that they should be treated as carried on in the UK for regulatory purposes. These issues at the perimeter of the regulatory regime can result in uncertainty for some non-EEA insurers when doing business in the UK or with the UK insurance market.

7.1.3 In this chapter, we first set out the applicable EU and UK regulatory frameworks and the specific activities for which insurers require authorisation. We then consider the extent to which the regime would apply in Scenarios 1 and 3 described in Chapter 1, where ABC is a non-EEA insurer (headquartered in Japan by way of example) instead of an EEA insurer. Finally we pose the question as to whether it may be desirable to seek a clarification of the rules.

7.2. EU REGULATORY FRAMEWORK

7.2.1 Article 162(1) of the Solvency II Directive provides that:

> "*Member States shall make access to the business [of direct insurance] by an undertaking with a head office outside the Community subject to an authorisation.*"

7.2.2 This wording is copied word for word from the insurance directives which preceded Solvency II.[31]

7.2.3 Given a literal interpretation, "access to the business" could mean "being a party to a contract with a policyholder" in the relevant jurisdiction, and if this meaning were adopted it would mean that it would never be possible for a non-EEA insurer to enter into a contract with a UK policyholder without becoming authorised.

[31] See Article 51(1) of the Consolidated Life Insurance Directive (2002/83/EC) and Article 23(1) of the First Non-Life Directive (73/239/EEC).

7.2.4 As explained below, the UK has always adopted an interpretation of this wording which focuses on the activities that the (re)insurer carries on in the UK – requiring analysis of whether they amount to effecting or carrying out contracts of insurance in the UK. However, the literal interpretation would appear to be supported by the European Commission ("Commission") which, in July 2015, expressed the view that the effect of Article 162 is that "a third country insurance undertaking may only insure risks located in a member state through a branch authorised by the competent supervisory authority of that member state". [32]

7.2.5 The Commission's interpretation does not represent binding law, but it creates considerable uncertainty over an issue of fundamental importance for offshore insurers.

7.2.6 If the nature of the activities of non-EEA insurer is such that it requires an authorisation then the process under Article 162 of the Solvency II Directive will apply. Article 162 lays down a number of conditions that must be satisfied by the insurer, including that it must establish a branch in the Member State where it is seeking the authorisation.

7.2.7 Article 162 does not apply to a non-EEA <u>re</u>insurer, so the authorisation of a non-EEA reinsurer is a matter solely for the national law of the Member State in which it carries on business. In theory, therefore, it would be possible for a non-EEA reinsurer to seek authorisation in an EEA Member State without having a branch in that Member State (although from a practical perspective it is questionable if an EEA regulator would ever be likely to accept such an arrangement, given the additional difficulties of regulating the (re)insurer effectively).

7.2.8 However, in the UK the PRA has decided that the same rules should apply to branches of non-EEA pure reinsurers as apply to branches of non-EEA direct insurers – see rule 15.1 of the "Third Country Branches" part of the PRA Rulebook. It is notable that the rules in this part of the PRA Rulebook only apply where the non-EEA (re)insurer has a branch in the UK, and there are no corresponding rules to cover a scenario where authorisation is granted in the absence of a branch. This suggests that the PRA does not contemplate ever granting such an authorisation.

7.2.9 Having a branch authorised in an EEA Member State does not entitle a non-EEA (re)insurer to exercise any passporting rights into other Member States, so if it wished to carry on business in more than one Member State then it would need to obtain separate authorisations in each relevant Member State.

7.2.10 Article 167 of the Solvency II Directive allows a non-EEA (re)insurer that has obtained authorisation in more than one Member State to apply to the regulators in those Member States for approval to meet the applicable Solvency II capital requirement by a deposit

[32] See minutes of meeting on the "Expert Group on Banking, Payments and Insurance", July 2015.

into one of those Member States, rather than separate deposits into all of those Member States.

7.2.11 As noted in Chapter 3, there is a difference between the definition of "branch" which applies for purposes of passporting, and the definition of "branch" that applies in Article 162 when determining whether an EEA branch of a non-EEA insurer requires an authorisation:

> *'branch' means a permanent presence in the territory of a Member State of an undertaking [with a head office outside the EEA which is accessing direct life and non-life insurance business in EEA], which receives authorisation in that Member State and which pursues insurance business.*

7.2.12 Unlike the passporting definition, there is no express reference to "agency" or an independent person. It is therefore questionable whether the same tests would apply in determining whether a third party agent could be regarded as a permanent presence of the non-EEA insurer.

7.2.13 In addition, the Article 162 definition contains a requirement that the branch "pursues insurance business", which is not included in the definition that applies for purposes of passporting. This supports the view that a permanent presence which carries on purely non-insurance activities would not require authorisation under Article 162.

7.3. UK REGULATORY FRAMEWORK

7.3.1 As explained in Chapter 5, the UK financial services regulatory regime is governed by FSMA, which provides that it is an offence to carry on a "regulated activity" by way of business in the UK unless authorised or exempt. The principal "regulated activities" relevant to the activities of (re)insurers are:

(a) the activity of "effecting contracts of insurance"; and

(b) the activity of "carrying out contracts of insurance".[33]

7.3.2 The activities of effecting and carrying out contracts of insurance in the UK are subject to regulation regardless of the location of the underlying policyholders or risks. Accordingly, an overseas insurer may be subject to regulation by the UK authorities with respect to UK operations, even where its policyholders are wholly outside the UK. Similarly, an overseas insurer which has UK policyholders may be able to avoid regulation by the UK authorities even where its policyholders are wholly within the UK. Whether this is possible requires a close examination of the two principal regulated activities.

[33] Article 10 RAO.

Effecting contracts of insurance as principal

7.3.3 Effecting contracts of insurance clearly covers the action of actually entering into or "binding" an insurance contract. The extent to which the activity of the (re)insurer leading up to that point falls within this category, is, however, less clear.

7.3.4 The RAO itself does not provide a definition of "effecting" contracts of insurance, and the UK regulators have not published any substantive guidance as to its scope. This can be contrasted, for example, with insurance mediation activities, for which the FCA has provided some guidance in the form of Chapter 7 of the Perimeter Guidance manual (PERG) of the FCA Handbook.

7.3.5 The issue has, however, been addressed on at least two occasions by the English courts, albeit in judgments pre-dating the current FSMA regime. This case law is still likely to be followed by the courts following FSMA: FSMA refers to the same concepts as the previous legislation, and if Parliament had intended different rules or meanings to apply it could have been expected to make this clear in the text of FSMA.

7.3.6 In *Stewart v Oriental Fire and Marine Insurance Co Ltd.*[34], reinsurers based overseas entered into reinsurance transactions with UK cedants via certain sub-agents operating in the UK. The sub-agents negotiated and accepted business from brokers on behalf of the reinsurers, subject only to obtaining the signature of the reinsurers' agents in Switzerland, who had authority to bind. The reinsurers attempted to argue that since the decision to bind the contract took place overseas, the reinsurers were not effecting contracts of insurance in the UK. The court held that "effecting" involves "more than merely making the contract. There is also ... the offering of insurance services and the negotiation of the terms of the contract ".

7.3.7 The scope of this regulated activity was also considered in *Re Great Western Assurance Co SA and ors.*,[35] which also involved certain offshore insurers carrying on business through agents (broker firms) operating in the UK. The activities of the agents included selecting risks to refer to the offshore insurers within agreed guidelines, using their knowledge and experience in advising of likely premium rates and making recommendations to the insurers as to the acceptance of particular risks. Although all decisions as to the acceptance of risk were taken offshore and the UK agents did not have authority to bind the offshore insurers, the Court of Appeal held that the offshore insurers were carrying on insurance business in the UK in those circumstances.

7.3.8 A similar outcome had previously been reached by the High Court in *DR Insurance Co v Seguros America Banamex*.[36] In that case an insurance agent bound reinsurance agreements on behalf of a reinsurer which were automatically retroceded to two retrocessionaires.

[34] [1985] QB 988.
[35] ([1997] Lloyd's Rep 377.
[36] [1993] 1 Lloyd's Rep. 120

Although the final decision to bind the insurance was taken by the reinsurer in its home jurisdiction, the activities of the agent - in drawing up a slip and then confirming that the contract was bound following the decision by the reinsurer – took place in London and meant that reinsurance was being carried on in the UK.

7.3.9 Following these cases, it would appear that a range of activities can each constitute the regulated activity of "effecting" contracts of insurance, including sourcing business, selecting opportunities for consideration, negotiating terms and binding risks.

Carrying out contracts of insurance as principal

7.3.10 As with "effecting", no definition is available in the legislation nor in regulatory guidance, but this activity can be characterised as comprising any substantive interaction between the insurer and a policyholder that relates to the performance of the insurance contract once it has been entered into, and would include collection of premium and handling and settling claims.

7.3.11 In the UK, this issue has been the subject of some analysis by the English courts. In *Stewart v Oriental Fire and Marine Insurance Co. Ltd*[37], it was held that effecting contracts of insurance could include offering insurance services and the negotiation of the terms of the contract. However, by implication, it is generally considered that a mere representative office whose purpose is to advertise the availability of insurance services in an overseas jurisdiction, but not to engage in discussions with potential policyholders, would not amount to effecting contracts of insurance, and therefore no authorisation would be required.

7.3.12 The working group who prepared this paper are aware of many examples of non-EEA (re)insurers entering into insurance and reinsurance contracts with UK policyholders and (re)insurers without any authorisation to pursue business anywhere in the EEA, on the basis that they do not take part in any negotiation or claims management inside the EEA. This relies on a concept known in other areas of financial services regulation[38] as "reverse solicitation", whereby the customer seeks out the provider of financial services, rather than the financial services provider seeking out the customer, and where no representative of the provider ever leaves its home jurisdiction for the purposes of negotiating or performing the contract. There is significant doubt in these other areas about how far "reverse solicitation" may be relied upon in practice.

7.3.13 In particular, there is a question regarding how much reliance can be placed on third parties located in the UK to assist in the negotiation – for example, brokers and lawyers. The question regarding the broker can be resolved on the basis that the broker is a representative of the policyholder, so its actions in negotiating the contract are not actions of the (re)insurer - even if in practice its knowledge of the (re)insurer's negotiating

[37] [1985] 1 QB 988
[38] For example, under the Alternative Investment Fund Managers Directive (2011/61/EU).

position makes it operate in much the same way as a representative of the (re)insurer. Lawyers might be regarded as mere scribes, writing down what the parties agree, but it is easy to imagine their role expanding beyond this into an active negotiating role.

The EU formulation: "Taking up" and "pursuit" of business, and "access to the business"

7.3.14 The separate identification of the activities of "effecting" and "carrying out" contracts of insurance is a UK formulation. It is not dictated by Solvency II. Solvency II refers in its heading to the "taking-up and pursuit of the business of direct insurance or reinsurance". Under this classification, "taking-up" (which is used in Article 14) appears to mean the act of becoming a (re)insurer, and "pursuit" (the word "pursue" is used in Article 15) appears to mean doing business as a (re)insurer.

7.3.15 As noted above, slightly different terminology appears in Article 162 of Solvency II, which deals with the authorisation of a branch of a non-EEA direct insurer. Article 162 provides that Member States shall make "access to the business [of direct insurance]" by an undertaking with a head office outside the Community subject to an authorisation. In practice, it appears that the UK regulators are interpreting Article 162 in line with the meanings given to the two regulated activities laid down by the FSMA regime, rather than applying a more literal interpretation to the words "access to the business".

7.3.16 The very broad terms used in Solvency II, and in its predecessor EU directives, have led the UK to adopt the more descriptive classification of "effecting" and "carrying out" contracts of insurance. This classification has the advantage of allowing the regulator to remove a (re)insurer's permission to "effect" new contracts, while still allowing the (re)insurer to maintain its "carrying out" permission so that it can fulfil its obligations to existing policyholders under existing contracts of insurance.

7.3.17 However, the fact that Solvency II does not mandate a particular classification means that the EU does not have harmonised rules on what is and is not permitted to be done in the absence of authorisation. The lack of harmonisation is increased by the fact that Article 162 is limited to direct insurance, so leaves entirely open to the Member State what conditions it will apply for pure reinsurers. For non-EEA (re)insurers, it is therefore necessary to consider what is permitted in each EEA member state on a Member State by Member State basis.

7.3.18 It is also notable that there appears to be inconsistency between (i) the circumstances in which an EEA (re)insurer would need to follow the passporting notification process in order to enter into a contract with a UK policyholder and (ii) the circumstances in which a non-EEA (re)insurer requires authorisation in order to enter into a contract with a UK policyholder. As explained in Chapters 3 and 5, the definitions of "host member state", "member state of the commitment" and "member state in which the risk is situated" in Solvency II, and the applicable FSMA provisions and regulatory guidance in the UK, have the effect that whether a passporting notification is required depends on where the

policyholder is habitually resident (and certain other factors relating to the policy in the case of non-life insurance), and not on where the activities of the (re)insurer take place. By contrast, at least in the UK, the need for a non-EEA (re)insurer to obtain an authorisation depends on the nature and extent of its activities in the UK.

7.3.19 This inconsistency shows suggest that the regulation lacks the coherent underlying logical framework that is necessary for consistent and predicable rules to be developed.

7.4. ANALYSIS OF SCENARIOS

SCENARIO [1] – UNDERWRITING THROUGH APPOINTMENT OF UK AGENT

7.4.1 In this scenario, Insurer ABC has its head office in Japan. It appoints D as its underwriting agent in London to underwrite D&O insurance up to a maximum level of $10m per risk, but otherwise D has authority to underwrite without limit as to terms or form, to collect premium and to handle and pay claims. D consults with ABC regularly and changes its underwriting guidelines in accordance with ABC's requests. D accounts for premiums received and claims paid monthly.

Do the activities being undertaken in Scenario [1] constitute the effecting and/or carrying out contracts of insurance?

7.4.2 The activities being undertaken in this scenario clearly constitute the regulated activities of effecting and carrying out contracts of insurance. As described above, "effecting" contracts of insurance most clearly applies to the activity of binding insurance contracts, which is being carried on here by the agent through the delegated authority arrangement it has entered into with the insurer. The agent will also be engaged in the selection of risks and the offering and negotiation of terms, which may also constitute "effecting". The collection of premiums and handling and settling claims relating to the contracts once entered into would constitute the regulated activity of "carrying out" contracts of insurance.

Are these activities being undertaken in the UK?

7.4.3 In this scenario the activities are being undertaken by D and not by ABC directly. However, D is acting as the agent of ABC since it has authority to deal with insured third parties on behalf of ABC. Its actions would therefore be attributed to ABC under the UK regime.

7.4.4 This was confirmed in *Re Great Western Assurance Co.*, where, as noted above, the UK-domiciled agents had been selecting risks (from producing brokers) for offshore insurers and making recommendations as to terms. They were also receiving notification of

claims, instructing loss adjusters and settling claims below a specified amount on behalf of the insurers. The court held that each of these activities was

> *"capable of being evidence that the Offshore companies were carrying on activities in the United Kingdom and collectively amount to overwhelming evidence that they were carrying on insurance business in the United Kingdom.... The activities were systematic and regular. Even though the [brokers] carried them out on behalf of the Offshore companies, they were just as much the activities of the Offshore companies as if those companies had carried them out directly through their own employees".*

7.4.5 It is clear that ABC would require authorisation in the UK in this scenario since D is effecting and carrying out contracts of insurance on its behalf in the UK. This applies irrespective of whether the agent is itself authorised by the UK authorities to carry on insurance mediation activities.[39]

SCENARIO [3] – LIAISON OFFICE

7.4.6 In this scenario, ABC has a liaison office in London staffed by a director, an underwriter and four administrative staff. The director and underwriter meet with brokers and refer them to ABC's head office in Japan if they think that the brokers have business that would be of interest to ABC. ABC is only interested in commercial insurance and reinsurance. The London staff also deal with administrative issues on risks underwritten by ABC in Japan and liaise over claims. As the insurer, ABC will in this scenario clearly be effecting and carrying on contracts of insurance. The more difficult question is whether it would be deemed to be doing so *in the UK*.

7.4.7 There is a basic recognition within FSMA that interpretive issues can arise when there is a cross-border element to the carrying on of regulated activities. Section 418 of FSMA provides several examples of where a person is to be regarded as carrying on a regulated activity in the UK, where it may not otherwise be clear. The fourth example states that this is the case where a firm's head office is not in the UK, but the activity is carried on from an establishment maintained by it in the UK.

7.4.8 Chapter 2.4 of PERG (which concerns the link between regulated activities and the UK) contains an illustrative example involving an investment management firm, where the firm's management is in country A, the assets are held by a nominee in country B, all transactions take place in country B or country C but all decisions about what to do with the investments are taken from an office in the UK. It states that "*Given that the investments are held, and all dealings in them take place, outside the United Kingdom there may otherwise be a question as to where the regulated activity of managing investments is taking place. For the purposes of the Act, it is carried on in the United Kingdom.*" This confirms the rule that an activity may be treated as carried on in the UK where some, but not all of its stages

[39] Firms engaging in regulated activities such as "arranging" contracts of insurance (Art. 25 RAO) and "dealing" (Art. 21 RAO) on behalf of insurers are subject to regulation as insurance intermediaries.

are carried on in the UK. But in the example given, the UK stage is clearly crucial, since investment decisions are being made there.

7.4.9 Similarly, in *Financial Services Authority v Fradley & Woodward*[40], the High Court determined, in the circumstances of the case, that the UK regime was applicable where the activities that took place in the UK were a "significant part" of the regulated activity. The case involved the operation of a collective investment scheme by two individuals, one of which was a certain Mr. Fradley. Initially, Mr. Fradley operated his business from an establishment in the UK but subsequently moved his office to Ireland. He contended that he ceased to be subject to the UK regime once he moved to Ireland, however communications with clients and prospective clients continued to take place on a regular basis in the UK and bank accounts and an accommodation address were maintained in the UK. The court held that a "significant part" of the business activity of running a collective investment scheme was being carried on in the UK. The activities were happening with sufficient regularity and substance to constitute carrying on regulated activities in the UK, even after Mr. Fradley moved his office to Ireland and was giving his instructions by post or internet.

7.4.10 But in essence, the question of how much of any particular activity must be carried on in the UK to result in a firm falling within the regime is one which must be decided on a case by case basis. The lack of clear parameters around when an insurer may be effecting or carrying out contracts of insurance "*in the UK*", means that there is a spectrum of more limited operations that an overseas insurer might undertake in the UK where a degree of judgement is required as to whether the activities would be sufficiently significant to bring the insurer within the regime. This is true whether the insurer is acting through its own employees located in the UK, or via an agent. We examine some of these activities below in the context of Scenario 3.

Referral of brokers to ABC headquarters in Japan

7.4.11 As discussed in section 4 above, *Re Great Western Assurance Co.* suggests that where risks are being regularly referred to the insurer for consideration by persons in the UK, this can amount to "effecting" contracts of insurance. In that case the brokers were "working within guidelines agreed with the offshore insurers and applying these in deciding what risks to refer to the insurers". The degree to which the UK operation is making a selection is probably the most important factor. In this instance it would appear that there is a reasonable degree of judgment being applied, and so it would likely constitute regulated activity (as opposed to a situation where, for example, the liaison office is merely providing a point of contact and automatically referring queries to the head office). However, the dividing line may be less clear if the onshore personnel are filtering enquiries to a more limited degree.

[40] *Financial Services Authority v Fradley & Woodward* [2005] EWCA Civ 1183.

Holding meetings with insureds, and other communications

7.4.12 Holding meetings with insureds (or brokers) in the UK prior to concluding a transaction can amount to carrying on regulated activity depending on the nature of those meetings. If the meetings are for the purpose of introducing the respective businesses to one another, or for preliminary discussions regarding what the counterparty may be looking for in broad terms, it is unlikely that this activity would constitute the regulated activity of effecting contracts of insurance. By contrast, where the meetings involve discussing a particular transaction, the insurer is likely to be deemed to be conducting regulated activity in the UK by being engaged in the "offering and negotiating process", following *Stewart v Oriental Fire*.

7.4.13 However, there is an open question as to when such meetings may constitute a "substantial part" of the regulated activity. This is a question that is often faced by non-EEA insurers that do not have a liaison office or other permanent presence in the UK, but are engaging in negotiations with a UK counterparty on an insurance or reinsurance transaction. It may be convenient in those circumstances to travel to the UK for limited periods to hold face to face meetings in order to discuss the possibility of a transaction, or to negotiate terms, but doing so has the potential to bring the (re)insurer within the UK regime.

7.4.14 Similar issues can arise where an officer of the insurer happens to be visiting the UK, or is temporarily located in the UK, for reasons unrelated to the transaction in question, but participates in communications with a counterparty (who may itself be located overseas) while in the UK. The officer may be only one member of a larger transaction team, but might, for example, dial into several conference calls, or send a limited number of emails relating to the transaction while he or she is in the UK. It is not clear how much of such activity is permissible before the insurer would be treated as carrying on a "substantial part" of the activity in the UK.

Liaising with policyholders regarding claims

7.4.15 As described above, the regulated activity of "carrying out" contracts of insurance involves activities undertaken once the contract has been entered into, including the handling and settling of claims. In *Great Western Assurance Co* the brokers were involved in receiving notification of claims, instructing loss adjusters and settling claims below a specified amount, which activities were held to fall within the UK regime. Whether the UK activity in Scenario [3] would bring the insurer onshore is likely to depend on the degree of independence that the UK personnel have to settle the claims. If the liaison office is purely receiving claims and forwarding them on to employees in Japan, without communicating with policyholders over the substantive content of the claim or being involved in any settlement activities, it is perhaps unlikely that this would amount to regulated activity. But if this activity forms a more important part of the claims handling

process, it might require authorisation in the UK, but again there is no obvious dividing line.

Other administrative functions

7.4.16 Locating personnel in the UK to perform purely internal administrative or back office activities such as IT, HR and legal services, should not bring ABC within the scope of the FSMA regime. By contrast, if it engaged in claim payment or liaison with loss adjustors, this would be expected to amount to carrying out contracts of insurance and therefore would bring ABC within the FSMA regime.

7.5. CONCLUSION – IS FURTHER CLARIFICATION NECESSARY OR DESIRABLE?

7.5.1 In summary, there is limited authoritative guidance as to what constitutes "effecting" or "carrying out" contracts of insurance in the UK, in circumstances where a non-EEA insurer has UK operations of a non-substantial or temporary nature.

7.5.2 Further research and consultation would be required to determine whether this is seen by overseas insurers or others in the industry as a material concern, and therefore whether further clarification from regulators might be welcome. Arguably, some non-EEA insurers are currently restricting their activities in ways in which the UK framework may not ultimately require. For example, in the experience of the authors, overseas (re)insurers that do not have any permanent UK presence tend to err on the side of caution when engaging in talks with UK counterparties regarding a potential transaction by ensuring that face to face meetings do not occur in the UK. This is often driven by tax considerations, as well as regulatory ones. Nevertheless we would query whether there is any practical difference, from a regulatory perspective, between such communications being made by personnel located in the insurer's offices overseas, or travelling to the UK temporarily for discussions.

7.5.3 By analogy, intermediaries are able to benefit from an exclusion with respect to "arranging" or "dealing in" regulated transactions where the person does not have a permanent place of business in the UK and the transaction is entered into with a counterparty, or through another intermediary, that is itself authorised under the UK regime.[41] It may be possible to advance arguments that an overseas (re)insurer with no permanent presence in the UK should be able to send employees to the UK to discuss a reinsurance transaction with a UK-authorised insurer, or the insurance of a corporate policyholder of a certain size without falling within the FSMA regime.

7.5.4 On the other hand, some non-EEA insurers may welcome that the regulators are afforded a degree of freedom to interpret whether the regime applies in borderline cases.

[41] Art. 72 RAO. This is known as the "overseas persons exclusion".

There is a danger that highly prescriptive guidance may result in regulators feeling compelled to apply the regime in a rigid manner that doesn't necessarily serve the aims of the legislation.

7.5.5 In the near term it is perhaps unlikely that the UK regulators (or legislators) would consider a lack of clarity around the fringes of the UK regime as applied to non-EEA insurers to be a priority. But these questions will no doubt come into focus to the extent that, following Brexit, EEA insurers lose their rights to passport into the UK and fall subject to the UK regime to the same extent as non-EEA insurers currently.

CHAPTER 8
DIGITAL SINGLE MARKET

8.1. INTRODUCTION

8.1.1 The term Digital Insurance is a broad one, covering a wide range of matters such as the use of online placing platforms[42], insurance comparison websites and the sale of insurance products via the internet. Technological developments and the digitalisation of information are topical issues that all (re)insurers are coming under increasing pressure to grapple with, whether this be to reduce operating costs, help distribute their products or to analyse risks.

8.1.2 This chapter will not attempt to deal with all areas of Digital Insurance but will instead focus on the sale of insurance products online and the regulatory issues that arise in this regard. These will be explored by reference to three hypothetical scenarios A-C below.

Scenario A

8.1.3 **Insurer A has its head office in Paris, France. It intends to operate a website whereby it will sell insurance products directly to consumers and businesses in the UK. Insurer A is already authorised in France to enter into the type of insurance contracts it wishes to offer and currently has no operations in the UK.**

Scenario B

8.1.4 **Insurer B is headquartered in London. It intends to operate a website whereby it will sell insurance products directly to consumers and businesses in the UK and other EEA States. Insurer B is already authorised in the UK to enter into the type of insurance contracts it wishes to offer. Insurer B currently has no other EEA offices/operations.**

Scenario C

8.1.5 **Insurer C is headquartered in Tokyo, Japan. It intends to operate a website whereby it will sell insurance products directly to consumers and businesses in the UK and other EEA States. Insurer C currently has no authorisation from any EEA State.**

8.1.6 In all scenarios, it is to be assumed that the particular type of insurance being sold is a regulated activity[43] and that the risk being insured is situated in the same country as the

[42] See for example, Lloyd's Placing Platform initiative https://www.lloyds.com/the-market/communications/regulatorycommunications-homepage/regulatory-communications/regulatory-news-articles/2016/08/placing-platform-limited

[43] In the UK context, see section 22, Financial Services and Markets Act 2000 and the Financial Services and Markets Act 2000 (Regulated Activities) Order 2001

customer purchasing the insurance. It should be noted that the Financial Promotions[44] regime may also apply to these three scenarios but this is not considered in this paper.

8.2. SELLING INSURANCE VIA A WEBSITE – A RIGHT OF ESTABLISHMENT OR SERVICES PASSPORT?

8.2.1 Before considering the individual scenarios, it is worthwhile exploring how online sales/use of a website would be analysed under the Solvency II Directive.

8.2.2 Chapter 3 of this paper summarises the passporting rules that apply under Solvency II, and in particular the meanings given to the terms "branch", "home member state", "member state of the commitment" and "member state where the risk is situated".

8.2.3 The Solvency II rules do not directly grapple with online services, but they do imply that a physical presence is required before a (re)insurer could be considered to be established within another Member State. In the UK, the PRA also takes the view that this means a physical presence, rather than the mere availability of a website.[45] EU case-law also supports this view.[46]

8.2.4 It might be asked whether owning or renting servers in an EU Member State might be regarded as a physical presence of the (re)insurer, so as to amount to a branch. The PRA view and the EU case law would imply that this would not be sufficient. It seems likely that there needs to be some form of human economic activity at the establishment in order for there to be the necessary physical presence meant by the Solvency II Directive. The wording of Article 145 of the Solvency II Directive provides some further support for this view in referring (albeit on a non-exclusive basis) to "an office managed by the own staff of the undertaking or by a person who is independent but has permanent authority to act for the undertaking as an agency would."

8.3. SCENARIO A

8.3.1 In this scenario, the French insurer will be seeking to "provide services" into the UK by writing a policy covering a risk in the UK. The website in itself, for the reasons discussed in section 2 above, is not an establishment. In addition, as Insurer A is only going to be selling products using a website, it is not establishing any physical presence in the UK.

8.3.2 In these circumstances, Insurer A will have the right to sell the insurance products online as cross-border services. It would therefore be required to provide a services passporting notification pursuant to Articles 147 et seq. of the Solvency II Directive.

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[44] See s.21 Financial Services and Markets Act 2000

[45] See heading "Scope": http://www.bankofengland.co.uk/pra/Pages/authorisations/passporting/faqs.aspx#7

[46] See, for example, Case C-386/04 *Centro di Musicologia Walter Stauffer* [2006] ECR I-8203 § 19, 20 and Case C-205/84 *Commission v Germany* [1986] ECR 3755 §21. These cases are anecdotal and do not consider specifically the question of websites being establishments.

8.4. SCENARIO B

8.4.1 In relation to the activities being carried out online in the UK, Insurer B will be able to rely on its existing authorisation.

8.4.2 The analysis with respect to sales to other EEA states is similar to Scenario A above. Insurer B will need to assess which countries in the EEA it intends to write risks, and then seek to passport outwards on a services basis.

8.5. SCENARIO C

8.5.1 This scenario is slightly more complex as Insurer C has no passporting rights given that it is not currently authorised in the EEA. Although Japan has been granted some temporary equivalence under aspects of Solvency II[47] this does not amount to a right to passport based on Japanese regulation.

8.5.2 In this Scenario, Article 162 of the Solvency II Directive will apply, and it will be necessary for Insurer C to establish a branch in each EEA Member State in which it wishes to sell insurance policies and to obtain authorisation for that branch from the regulator in that Member State. If it adopts this approach, it will not be possible for any of the branches to passport to other Member States. Accordingly, for each new Member State in which it wishes to sell insurance, it would need to obtain a fresh authorisation.

8.5.3 This process could become enormously complex and could give rise to competing regulatory burdens.

8.5.4 An alternative would be to establish a subsidiary in one EEA Member State and have it authorised as an insurer. That subsidiary would then be permitted to passport from one EEA Member State to another under the Solvency II passporting rules, without having to obtain a fresh authorisation in each new Member State. However, the subsidiary would be a separate legal entity from Insurer C which may have adverse consequences for Insurer C. For example, Insurer C and the new subsidiary would not benefit from full diversification of their respective businesses in determining technical provisions and capital requirements. In addition, it would be necessary to make clear that it is the subsidiary which is selling insurance through the website, and not Insurer C itself – this may require changes to the infrastructure and agreements by which the website is operated.

8.6. E-COMMERICE DIRECTIVE

8.6.1 In our three scenarios, Insurers A, B and C will clearly be placing insurance via the websites and therefore "effecting and carrying out insurance contracts" for purposes of

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[47] Commission Delegated Decision (EU) 2016/310 http://eur-lex.europa.eu/legalcontent/EN/TXT/PDF/?uri=CELEX:32016D0310&from=EN

FSMA – please see the discussion of these activities in Chapter 7. The Insurers are also likely to be arranging insurance contracts[48] and potentially also advising on such products[49].

8.6.2 It should be noted that the EU E-commerce Directive (2000/31/EC) ("E-commerce Directive") provides a distinct framework for certain types of activities. In the UK, this has resulted in certain activities that would otherwise be regulated activities being excluded from the regulatory regime by virtue of Article 72A of the Financial Services and Markets Act 2000 (Regulated Activities) Order 2001 (the "RAO"). However, this exclusion does not apply to insurers effecting and carrying out contracts of insurance. Article 72A provides that:

> "*(1) There is excluded from this Part any activity consisting of the provision of an information society service from an EEA State other than the United Kingdom.*
>
> *(2) The exclusion in paragraph (1) does not apply to the activity of effecting or carrying out a contract of insurance as principal, where the insurance falls within the scope of the Solvency 2 Directive.*"

8.6.3 As a result, EU (re)insurers cannot rely on the exclusion in Article 72A(1) to allow them to effect or carry out (re)insurance activities in the UK without passporting into the UK in accordance with the normal passporting procedure.

8.6.4 An "information society service" is defined by Article 2 of the E-commerce Directive as any service normally provided for remuneration, at a distance, by means of electronic equipment for the processing (including the digital compression) and storage of data at the individual request of a service recipient. This will include arranging or advising on the sale of insurance online.

8.6.5 As to whether it is being performed "from an EEA State other than the United Kingdom", reference should be made to s.417(4) of the Financial Services and Markets Act 2000:

> "*For the purposes of this Act—*
>
> (a) *an information society service is provided from an EEA State if it is provided from an establishment in that State;*
>
> (b) *an establishment, in connection with an information society service, is the place at which the provider of the service (being a national of an EEA State or a company or firm as mentioned in [Article 54] 45 of the Treaty) effectively pursues an economic activity for an indefinite period;*

[48] Article 25, the Financial Services and Markets Act 2000 (Regulated Activities) Order 2001
[49] Article 53, the Financial Services and Markets Act 2000 (Regulated Activities) Order 2001

(c) *the presence or use in a particular place of equipment or other technical means of providing an information society service does not, of itself, constitute that place as an establishment of the kind mentioned in paragraph (b);*

(d) *where it cannot be determined from which of a number of establishments a given information society service is provided, that service is to be regarded as provided from the establishment where the provider has the centre of his activities relating to the service.*"

8.6.6 In light of the definition above, if an insurer was based in France as in Scenario A, it would not make any difference to the analysis if its website was hosted elsewhere. The information society service will almost certainly be considered to be provided from France if this is where the insurer's centre of activities are based in relation to the service. Section 417(4)(c) makes it clear that the place of equipment or the technical means used for providing information will not, of itself, amount to an establishment.

8.7. DIGITAL SINGLE MARKET

8.7.1 On 6 May 2015, the European Commission issued a new Digital Single Market (**DSM**) strategy. The DSM has three key pillars:

8.7.2 Better access for consumers and businesses to online goods and services across Europe.

8.7.3 Creating the right conditions for digital networks and services to flourish.

8.7.4 Maximising the growth potential of the European Digital Economy.

8.7.5 Since the launch of the initiative, there have been a large number of consultations/proposals from the European Commission to address matters such as geo-blocking (the practice that prevents or limits access to goods or services to consumers based on their geographical location), parcel services and consumer protection. The DSM means insurers will also need to be alert to developments in areas such as data protection, copyright, consumer protection and consumer rules for online purchases; however this goes beyond the scope of considerations that will be particular to an insurer.

8.8. CONCLUSIONS

8.8.1 From the foregoing analysis it would appear that EEA Solvency II authorised (re)insurers will have the ability to use a services passport to promote their products online in other EEA Member States without the need to formally set up an establishment. This allows (re)insurers to increase their profile in other territories without necessarily undertaking the significant operational burdens that would come with being fully established.

8.8.2 However, the key determining elements of an "establishment" under the Solvency II regime (namely the need for physical presence and, probably, human economic activity) are factors (re)insurers need to continually monitor so as to ensure that they are not inadvertently found to be established in another EEA Member State; (re)insurers must not forget where they are doing business, particularly as this may change gradually over time.

8.8.3 The position is made slightly more uncertain for Solvency II (re)insurers that may wish to benefit from certain exemptions/rights under the E-commerce Directive as they are required to grapple with the two regulatory regimes. The definition of establishment, it is submitted, is not entirely consistent in that Solvency II does not expressly provide that the place of equipment or the technical means used for providing information will not, of itself, amount to an establishment.

CHAPTER 9
BREXIT – ACCESS TO THE UK INSURANCE MARKET

9.1. INTRODUCTION

9.1.1 Withdrawal from the EU does not of itself mean that UK (re)insurers and (re)insurance intermediaries will not be able to do business in EEA states. What it does mean is that they will not be able to carry on (re)insurance activities on an EEA-wide basis as a matter of right. The loss of passporting rights will be equally relevant to the cross-border activities of (re)insurers and (re)insurance intermediaries coming from the EEA into the UK.

9.1.2 This chapter considers, in particular, how Brexit will affect EEA (re)insurers' ability to access the UK (re)insurance market. It also looks briefly at the position of (re)insurance intermediaries. The precise terms on which both will be able to conduct cross-border activities will depend on the outcome of negotiations between the UK and the EU, on any requirements for reciprocity that may be agreed in that context or (failing this) on choices made by the UK government. There are a number of possible structural outcomes, some of which are considered below.

9.1.3 Brexit should not, of itself, affect how non-EEA (re)insurers and (re)insurance intermediaries access the UK market. Their position is not, therefore, considered further.

9.1.4 In this chapter, references to the "EU" and "EEA" should be taken to exclude the UK.

9.2. THE EUROPEAN UNION (WITHDRAWAL) BILL

9.2.1 The European Union (Withdrawal) Bill (the **Bill**) will play a decisive role in determining which laws apply in the UK immediately post-Brexit. It is currently envisaged that the Bill will, with effect from the date of the UK's withdrawal from the EU:

a. repeal the European Communities Act 1972;
b. incorporate EU law into domestic law; and
c. set out delegated powers to enable the UK government to adapt any laws that originate from the EU so as to fit the UK's new relationship with the EU.

9.2.2 Many questions remain about about how each of these issues will be tackled, including whether the government should be empowered to make changes over and above those that are strictly necessary to give effect to the relevant laws and make them work within the UK's new relationship with the EEA.

9.2.3 The starting point post-Brexit is, therefore, that the UK legal framework for (re)insurance will remain the same as it is today. In other words, EU (re)insurers and intermediaries

wishing to conduct (re)insurance activities in the UK will be subject to the same rules as currently apply to non-EEA (re)insurers wishing to access the UK insurance market, as described in Chapter 7.

9.2.4 There are two reasons why this may not be the case from the outset:

a. terms negotiated for the withdrawal of the UK from the EU may require the UK to change its approach to incoming firms, particularly those from the EU.

b. independently, the UK may decide to change the rules as they apply to non-UK firms, perhaps to show that the UK remains "open for business" or, in contrast, to make it more difficult for EU firms to access UK markets.

9.2.5 Another issue that remains unresolved at this stage concerns the authority, if any, that EU case law and guidance will have for the interpretation of the UK regulatory regime once it is no longer a Member State of the EU.

9.3. POST-BREXIT ACCESS TO THE UK INSURANCE MARKET- THE EXISTING REGIME

9.3.1 There are three approaches that an EEA (re)insurer may adopt to carry on cross-border business into the UK once the UK leaves the EU (see below for discussion of intermediaries). The preferred approach is likely to depend on a combination of the nature of the business being written and on arrangements agreed between the UK and EU for continued access to the UK market:

a. carry on business through a UK branch;

b. provide (re)insurance services into the UK without establishing a permanent presence here; and

c. write the business through a newly established (or existing) UK subsidiary

Only the first two are relevant to this paper. The third is not discussed any further.

EEA (re)insurer establishing UK branch

9.3.2 It is impossible to know now what rules will govern the establishment of a UK branch by an EEA (re)insurer post-Brexit. UK requirements currently applying to UK branches of non-EEA (re)insurers meet the requirements of Articles 162-175 of the Solvency II Directive. The same rules would apply, absent further change to the UK regime, to UK branches of EEA (re)insurers once they can no longer passport into the UK (see discussion of these requirements in Chapter 7).

9.3.3 Once the UK leaves the EU it will no longer be bound by Solvency II. It could, in theory at least, make it considerably harder for an EEA (re)insurer to establish a UK branch. In practice, maintaining, as close as is possible, access to EU markets for UK businesses means that this seems unlikely to happen, initially at least. Alternatively, the UK might take a more lenient approach to the authorisation and supervision of UK branches of EEA (re)insurers than it takes to branches of non-EEA (re)insurers.

EEA (re)insurer providing services into the UK

9.3.4 The position for EEA (re)insurers wishing to provide (re)insurance into the UK on a services basis (ie without having a permanent presence in the UK) is also unclear. As is discussed in Chapter 7, the UK has historically taken the view that authorisation is only needed by third country (re)insurers, which will include EEA insurers post-Brexit, if they are actually carrying on (re)insurance business here. In other words, they must be effecting or carrying out contracts of (re)insurance by way of business "in the UK" under the Financial Services and Markets Act 2000 (FSMA). If an overseas (re)insurer's activities are not caught by this definition, it does not require authorisation in the UK. It can access the UK market on what is commonly described as a "non-admitted" basis. Case law that considered when an insurer's activities in the UK are sufficient for it to be caught by FSMA is considered in Chapter 7 above.

9.3.5 Absent any change to FSMA (other than changes that inevitably flow from the loss of passporting rights), the rules described above should apply following Brexit to EEA (re)insurers in the same way they apply today to, for example, US (re)insurers.

9.3.6 Recent indications are, however, that some EU states, including Germany, are moving towards heavier regulation of non-admitted business than has been the case to date. Furthermore, as explained in Chapter 7, the European Commission (**Commission**) has expressed[50] the view that "a third country insurance undertaking may only insure risks located in a member state through a branch authorised by the competent supervisory authority of that member state". While this view does not accord with long-established UK law, and it can be argued that Article 162 was not intended to change the pre-existing legal position given that it uses exactly the same words as the insurance directives that preceded Solvency II, it is certainly possible that the CJEU would, if asked, agree with the Commission's view, given the literal interpretation of the words "access to the business" that are used in Article 162.

9.3.7 If the Commission's view is adopted by EEA states, it will affect UK (re)insurers' ability post-Brexit to write new business in EEA states on a non-admitted basis, ie without establishing a branch. If this turns out to be the case, the UK may decide to take the same

[50] See minutes of meeting on the "Expert Group on Banking, Payments and Insurance", July 2015.

approach, for reasons of reciprocity, to EEA (re)insurers wishing to access the UK market.

Grandfathering of existing contracts

9.3.8 If the Solvency II passporting rules cease to apply as between the UK and the EEA, the UK will become a "third country" for the purposes of Solvency II, and the EEA Member States will become third countries for the purposes of the UK insurance regulatory regime.

9.3.9 As explained in Chapter 7, for a third country (re)insurer to carry out contracts of insurance in the UK, it must establish a UK branch and obtain authorisation for it. Therefore, in the absence of other arrangements being made, an EEA (re)insurer which is currently relying on a passporting notification in order to carry out contracts of insurance which are already in place in the UK, would need to establish such a branch (if it does not already have one) and obtain such an authorisation at the time of Brexit.

9.3.10 Typically a branch authorisation may take between 6 and 12 months. A failure to obtain the authorisation would result in the EEA (re)insurer committing a criminal offence under FSMA if it carries out the contract. This would include payment of claims in the UK, although the policyholder would be entitled to enforce payment of its claim notwithstanding the insurer's lack of authorisation.[51]

9.3.11 Similarly, UK (re)insurers who currently carry on insurance activities in EEA Member States will potentially be acting illegally if they continue to perform their obligations under existing contracts of insurance in those EEA Member States.

9.3.12 It seems unlikely that either the UK or EEA Member States would be willing to allow a situation to arise where it was illegal for (re)insurers to pay claims to policyholders in their jurisdictions. Accordingly, although the position remains unresolved, we would hope some form of grandfathering arrangement could be agreed under which existing contracts may continue to be performed even before a branch authorisation has been obtained – at least for the time that it takes for an authorisation to be sought and granted.

9.3.13 Even if a grandfathering arrangement is agreed in respect of the carrying out of existing contracts of insurance, it does not follow that it would be granted in respect of "effecting" new contracts of insurance.

9.4. THE FUTURE UK/EU RELATIONSHIP

9.4.1 As indicated above, rules on access to the UK market applying to EEA (re)insurers post-Brexit will depend on the outcome of secession negotiations. There are a number of

[51] ss 26 & 28 FSMA

possible structural outcomes, apart from any bilateral arrangements arising from those negotiations. The main options which have precedents in the EU's relations with other countries are:

- EEA (European Economic Area)
- EFTA (European Free Trade Association)
- EU/UK FTA (Free trade agreement)
- Customs Union
- EU/UK CETA (Comprehensive Economic and Trade Agreement)
- WTO (World Trade Organisation)

9.4.2 The diagram below illustrates the implications of each approach for the UK.

	CONTRIBUTE TO EU BUDGET	FREE MOVEMENT OF PEOPLE	SCHENGEN OPEN BORDERS	PARTICIPATE IN EU LAW MAKING	EU MARKET ACCESS – GOODS	EU MARKET ACCESS – SERVICES	FINANCIAL SERVICES "PASSPORTS"	TRADE TREATIES WITH THIRD COUNTRIES
EU (UK terms)	Yes	Yes	No	Yes	Yes	Yes	Yes	Yes
EEA (Norway)	Yes	Yes	Yes	No	Yes	Yes	Yes	Some possibly
FTA (Switzerland)	Yes	Yes	Yes	No	Yes	Limited extent	No	No
Customs Union (Turkey)	No	No	No	No	Yes	No	No	No
CETA (Canadian)	No	No	No	No	Largely Tariff Free	No	No	No
WTO (Most of rest of world)	No	No	No	No	Most Favoured Nation Tariffs	No	No	No

9.4.3 Some of these structural options are discussed below. Others are not discussed further because they are primarily concerned with goods, not services, or because their impact on the issues discussed in this paper would be entirely dependent on the terms agreed between the relevant parties. The UK government has indicated that it will be seeking to obtain a bespoke arrangement for the UK with the EU, which does not replicate any of the existing structures. If it is successful in achieving this, the rules on access to (re)insurance markets which are the subject of this paper will depend on the precise terms of that arrangement and cannot be predicted today. Securing full access to EEA markets for UK (re)insurers, and vice versa, on the basis of mutual recognition of regulatory regimes would clearly have significantly different consequences for firms than if Solvency II rules on third country access to the EU are left to apply.

9.5. EEA (EUROPEAN ECONOMIC AREA)

9.5.1 If the UK were to become a member of the EEA from the date of its withdrawal from the EU, it would be committed to retaining the current, Solvency II regime in the UK. Rules applying to EU (re)insurers wishing to access the UK insurance market would remain unchanged from those applying today (as described in Chapter 3 and Chapter 7 above).

9.5.2 The UK government's confirmation that the UK will not remain within the free market post-Brexit means that it is now inconceivable that it will seek membership of the EEA. Even before that confirmation was given, it was very unlikely that this option would be pursued. On most free movement and trade issues and many EU social policy measures, membership of the EEA would oblige the UK to accept EU laws in those areas as they evolve without the UK having much say in their content. The CJEU would, in essence, remain the final court on issues of interpretation. In the context of Solvency II, membership of the EEA would require the UK to comply with Solvency II rules without having any role in how they might develop over time.

9.6. WTO (WORLD TRADE ORGANISATION)

9.6.1 The UK could opt to have no special relations with the EU at all. In that event, or if secession negotiations between the UK and the EU simply fail to produce any alternative arrangement, the UK's right to trade with the EU in both goods and services would be governed solely by the WTO rules, as both the EU and the UK are members. Recent indications from the UK government is that WTO membership will be its "fall-back" position should exit negotiations with the EU fail to reach a satisfactory outcome.

9.6.2 This would place the UK in a similar position to that currently enjoyed by the USA, but significantly less than that achieved by Canada under CETA (Comprehensive Economic and Trade Agreement) or that which the USA would achieve if its TTIP (Transatlantic Trade and Investment Partnership) negotiations with the EU are successful. The same applies as regards Australia and New Zealand, which are also negotiating a trade agreement with the EU.

9.6.3 In the case of financial services, there is an important distinction to be drawn between the concept of "market access" and domestic regulation. Even if a WTO member has a "market access" commitment, it can still impose "domestic regulation" (see, in particular, the "prudential carve-out" in the Annex on Financial Services). Regulatory barriers can then be addressed by mutual recognition of standards. If a WTO country concludes a mutual recognition agreement with one jurisdiction, it must provide "adequate opportunity" to other WTO members to join or negotiate a comparable agreement. The EU and UK's regulatory systems are currently integrated, and it is the UK's voluntary decision which will cause them to be separated. It could be argued that the UK is giving up the adequate opportunity which it has had to benefit from continuing

mutual recognition, and therefore will not be able to insist on mutual recognition with the EU even in a WTO context.

9.6.4 The EEC-Swiss Agreement on direct non-life insurance, which came into force in 1993, is an example of a mutual recognition agreement and has been notified as such to the WTO. Where the UK is left in a position of relying on the WTO to secure access to overseas markets, it could, therefore seek "adequate opportunity" to reach a similar agreement with the EU. The EEC-Swiss agreement is, however, extremely old and may have little value as a precedent for negotiations between the UK and the EU. In any case its application is limited when compared to the "free access" that the passport provides. Timing implications for reaching such an agreement are also unlikely to mean that there can be a seamless switch into such a new arrangement from the date of Brexit.

9.7. EQUIVALENCE

9.7.1 Under the Solvency II Directive, "equivalence" applies in the following three contexts:

a. **Article 172 – Reinsurance provided by a non-EEA reinsurer**: Reinsurance contracts between an EEA cedant and a non-EEA (re)insurer which is located in a jurisdiction whose solvency regime is assessed to "equivalent" for the purpose of this Article must be treated in the same manner as if the contract were concluded with an EEA (re)insurer.

b. **Article 227 – Group Solvency– related companies located in a non-EEA jurisdiction**: Where a Solvency II group contains a non-EEA (re)insurer which is located in a jurisdiction whose solvency regime is assessed to be "equivalent" for the purpose of this Article, the group may apply to use local rules in capital calculations carried out under the deduction and aggregation method. Such an application may or may not be granted.

c. **Article 260 – Group supervision**: Where a Solvency II group is headquartered in a non-EEA jurisdiction which is assessed as having a system of group supervision that is "equivalent" to that operated under Solvency II, EEA supervisors must rely on supervision of that group by the national supervisor in that jurisdiction.

9.7.2 The benefits third country (re)insurers gain from a finding of equivalence in each case fall considerably short of providing them with "free access" to EU markets. This is in contrast to the position under some other financial services directives, where a finding of equivalence would be considerably more meaningful in maintaining UK access to the EEA single market. Concerns about obtaining equivalence status include the limits it would place on the ability of UK regulators to depart from the current Solvency II regime and the need to sign up to future changes in Solvency II without having any say in their development. Some UK (re)insurers, at least, would favour a less onerous regulatory regime even if it meant not benefiting from equivalence.

9.7.3 For the UK to be assessed as equivalent, its regime will need to follow Solvency II closely. Although the term "equivalence" does not mean "the same", there is nonetheless a concern that the EU will require the UK to retain standards that are very close to Solvency II for equivalence status to be given. There is no automatic entitlement to achieving equivalence status, which raises the prospect of some political awkwardness about any assessment of the UK's regime, and how quickly the assessment will take place.

9.7.4 Of particular relevance to this paper, it is possible that the UK's desire to receive a favourable decision on equivalence will influence negotiations on rules relating to third country (including EEA) access to the UK (re)insurance market. This could mean, in particular, rules on establishment of branches by an EU (re)insurer remaining as described above for non-EEA (re)insurers.

9.8. INTERMEDIARIES

9.8.1 As is the case for (re)insurers, it is not possible to state with certainty what rules will govern the conduct of (re)insurance mediation activities in the UK by EEA intermediaries post-Brexit. Loss of passporting rights currently obtained under the Insurance Mediation Directive (in due course to be replaced by the Insurance Distribution Directive) means that it will be up to the UK to decide how to regulate incoming intermediaries.

9.8.2 Absent any indication to the contrary, it should be assumed that the same rules will apply to EEA intermediaries post-Brexit as currently apply to non-EEA intermediaries. An EEA intermediary will therefore need to obtain authorisation from the FCA if it is carrying on insurance mediation activities in the UK for the purposes of FSMA. As the Insurance Mediation Directive only establishes minimum standards for the regulation of intermediaries, individual Member States can in any case apply more onerous standards, as is already the case in the UK. Given this, it seems unlikely that the UK would wish to change its current approach.

9.9. DIGITAL ISSUES

9.9.1 As explained in Chapter 8, the EU is on the cusp of developing the EU Digital Single Market. Some EU legislation already exists, in the form of the E-Commerce Directive, and more is likely.

9.9.2 Brexit will mean that the UK will not be bound by, or be able to benefit from, the new rules that will be developed to develop the Digital Single Market. UK (re)insurers may therefore be in the position of the insurer in Scenario C of Chapter 8, whereby they will have to establish a branch and obtain a separate authorisation in each EEA Member State even to sell products over the internet. This would represent a very significant

inefficiency for UK (re)insurers when compared to competitors in EEA Member States who will be able to rely on a simple services passporting notification to access additional EEA Member States.

9.10. **IMPACT OF BREXIT IN SCENARIOS 1-3**

9.10.1 Whether this position changes will again depend on which, if any, of the structural options described above is agreed in negotiations for the UK's withdrawal and on other political decisions that have a bearing on access to UK markets.

9.10.2 As has been stated above, it is impossible at this stage to know how the cross-border activities of EEA (re)insurers will be regulated by the UK once it has left the EU and is no longer subject to Solvency II constraints. Absent any clear indication of where negotiations are likely to take us, the most likely scenario must be one where insurance passporting rights no longer apply and EEA Member States have the same status post-Brexit as non-EEA states have today.

9.10.3 Finally, equivalence status is not available under the Insurance Mediation Directive or Insurance Distribution Directive, so any decision the UK may take to change the regulatory regime can be made without this as a consideration.

9.10.4 Applying this approach, the impact of Brexit on Scenarios 1-3 discussed in this paper should lead to the same outcome for ABC as if it were headquartered today in Japan (as discussed in Chapter 7).

CHAPTER 10
SUMMARY OF AREAS OF UNCERTAINTY

10.1. Based on the foregoing chapters of this paper, the following are the key areas of uncertainty in the law:

a) **Continuing Relevance of the Interpretive Communication**: It is unclear to what extent the Interpretive Communication will be treated by Member States as representing the law, and to what extent (re)insurers can rely on it. In particular, it appears that Germany and The Netherlands have not incorporated the "direction and control" test into their law, and regulators in other Member States have either not acknowledged the Interpretive Communication (Poland) or have acknowledged it but emphasised its non-binding effect (the UK). This may reflect different views in different Member States about whether the Interpretive Communication may be relied on. The view could be taken that the Solvency II Directive definitions of "branch" in Articles 13(11) and 145 have now superseded the Interpretive Communication, so that anything not included in those definitions has now ceased to apply.

b) **Distinction between insurers and pure reinsurers**: It is not clear whether pure reinsurers would be treated as subject to a different standard than direct insurers in relation to carrying on business in other EEA Member States, given the absence of a notification procedure for exercising passporting rights;

c) **Uncertainties within the Interpretive Communication**: If the Interpretive Communication can be relied on as representing the law, a number of uncertainties exist within it:

i. the amount of control that is necessary in order for an independent person to be treated as subject to the "direction and control" of the (re)insurer, and whether there are any situations (such as where the companies are parent and subsidiary) where direction and control will be presumed or deemed;

ii. what is meant by the independent person being able to "commit" the (re)insurer – in particular, whether actions that might have the practical effect of binding the (re)insurer would amount to a power to commit the (re)insurer; and

iii. what is meant by the brief given to an independent person being "long-term" or "permanent" – in particular, where it is for a fixed period and capable of extension.

d) **Relevance of activities carried on by the branch**: Suppose an EEA (re)insurer establishes a branch in the UK, but that branch does not carry on activities that amount to effecting and carrying out contracts of insurance (see the discussion of the UK case law in Chapter 7). There is some uncertainty about whether it would be required to make an establishment passporting notification. Its activities in the UK would not be prohibited by FSMA, but Solvency II would seem to require the notification to be made irrespective of the limitation on its activities. A different outcome would appear to apply to a branch of a non-EEA (re)insurer.

e) **Inconsistency with rules applicable to non-EEA (reinsurers)**: As noted above, there appears to be an inconsistency within Solvency II itself regarding when an EEA (re)insurer will be regarded as having a branch in a Member State and when a non-EEA (re)insurer will be regarded as having a branch in a Member State. It is unclear whether this distinction is intended to make a difference, and therefore how far the distinction may be relied upon in practice. This difference is likely to become significant following Brexit if passporting rules will no longer apply between the UK and the members of the EEA.

f) **Definitions of regulated activities**: Solvency II does not have a clear definition of what constitutes "taking up" and "pursuing" insurance business, and what constitutes having "access to the market". As a result, for non-EEA insurers there is no harmonised set of rules defining when they will be required to establish a branch in an EEA Member State. The position is further complicated by the view of the European Commission, expressed in the minutes of a meeting in July 2015, that a non-EEA insurer may only insure risks located in a Member State through a branch authorised by the regulator in that Member State. There is doubt about whether this view represents the law, but it leaves considerable uncertainty in this area.

   This uncertainty adds to that which exists for non-EEA pure reinsurers, for whom Solvency II lays down no general rules regarding the establishment of branches in the EEA.

g) **Requirement for human economic activity**: Neither the Interpretive Communication nor Solvency II expressly contemplates whether an EEA (re)insurer could be considered to have a "permanent presence" in a Member State by reason of owning or renting computer servers which are permanently located there and which it uses for purposes of its (re)insurance business. The regulatory guidance and the UK case law all focus on human economic activity, rather than automatic computer activity relied upon by humans elsewhere. However, in the absence of a formal court decision, or legislative clarification, the position remains uncertain.

h) **Brexit**: At the time of writing, it remains unclear what arrangements will be made following Brexit. This is particularly acute uncertainty for (re)insurers who currently passport between the UK and other Member States of the EU. (Re)insurers who sell business over the internet may find that they are unable to rely on new EU rules that are to be introduced to facilitate the growth of the Digital Single Market, and this may result in their businesses being much less efficient than that of their competitors in other EEA Member States.