Insurance and Pensions Sector Report

1. This is a report for the House of Commons Committee on Exiting the European Union following the motion passed at the Opposition Day debate on 1 November, which called on the Government to provide the Committee with impact assessments arising from the sectoral analysis it has conducted with regards to the list of 58 sectors referred to in the answer of 26 June 2017 to Question 239.

2. As the Government has already made clear, it is not the case that 58 sectoral impact assessments exist. The Government's sectoral analysis is a wide mix of qualitative and quantitative analysis contained in a range of documents developed at different times since the referendum. This report brings together information about the sector in a way that is accessible and informative. Some reports aggregate some sectors in order to either avoid repetition of information or because of the strong interlinkages between some of these sectors.

3. This report covers: a description of the sector, the current EU regulatory regime, existing frameworks for how trade is facilitated between countries in this sector, and sector views. It does not contain commercially-, market- or negotiation-sensitive information.

Description of sector

4. Insurance business operates by firms writing insurance policies for clients, intermediated by brokers (which may include retail brokers and wholesale brokers and London Market brokers). Insurance firms in turn can pass on excess risk to reinsurance firms, via reinsurance brokers. Insurance underwriting requires large amounts of capital, so the industry tends to be dominated by large firms. The broking market on the other hand features large numbers of small specialist participants.

5. The insurance sector pools risk and protects households and businesses from losses resulting from harmful or catastrophic events. This includes the availability of competitively priced compulsory insurance, such as motor insurance or employer's liability cover. It also includes the provision of suitably sophisticated or bespoke cover to enable complex operations or investments; from shipping goods to operating power plants to mitigating cyber-attacks. The insurance industry also acts as a stable investor, supplying long-term investments which help to fuel wider economic growth.

6. The UK insurance sector contributed £23.bn to GVA in 2016, or 20.3% of financial services GVA and 1.3% of total UK GVA that year.[1] Insurance carriers employed 104,000 people in 2016 and auxiliary industries such as insurance brokerage 175,000.[2] Combined, this accounts for 29.8% of financial services jobs and 1.1% of

[1] ONS, GDP(O) Low Level Aggregates National Accounts, Industry codes 65.1, 65.2, 65.3, 2016
[2] ONS, Annual Survey of Hours and Earnings, Table 16.10a (revised), Industry codes 65 and 662, 2016

total UK employment.[3] The sector is estimated to have paid approximately 22% of the financial services sector's tax contribution.[4] Its net exports were £16.9bn in 2016, or 39% of financial services net exports.[5]

7. Different aspects of the insurance market are distributed differently across the UK. Retail insurance is present in most major urban centres, life insurance is mostly based in Edinburgh and the South East, and specialty (re)insurance is concentrated in London. The back-office functions for retail insurance firms are spread out across the UK and administrative support for specialty (re)insurance is typically concentrated in south and east England. The sector consists of two types of business: underwriters, who hold the risk and capital involved in providing insurance, and brokers, who handle sales, claims and marketing. It then breaks down into different product lines which have distinct business models:

Large Life Insurance Companies

8. There are around 10 large life insurance companies, which specialise in managing retirement savings, including pensions and annuities. Life insurers manage 80% of the more than £1.6trn in investments held by insurers, largely through around 21m individual pension pots.[6] They are significant long-term investors in the UK economy, for example via purchases of corporate bonds. Statistics are not available, but there is a significant concentration in the South East and Edinburgh. Life insurance and pensions business is tightly bound up with national tax and welfare systems, so business is typically conducted via UK-incorporated businesses, albeit a small number are part of European groups. However, many UK-based life insurers are developing internationally active asset management arms.

General Retail Insurers

9. Around 50 retail general insurance companies and thousands of brokers, which supply familiar consumer products such as car insurance, home insurance, travel insurance and health insurance. Brokers include online comparison, sectoral specialists, high street brokers for small businesses, and non-insurance companies that sell insurance as a side business (such as travel agents). Statistics are not available, but on a rough estimate retail insurance constitutes around two thirds of employment in the insurance sector, and is distributed all around the UK. Many leading retail insurers are owned by European groups, while an estimated 20% of UK motor insurance is provided from Gibraltar.[7]

London Market

10. Around 200 insurers and brokers in the London Market[8] for specialty (re)insurance. The London Market is a cluster of companies and the Lloyd's of London market, that

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[3] ONS, Annual Survey of Hours and Earnings, Table 16.10a (revised), Industry codes 65 and 662, 2016
[4] City of London, 'Total Tax Contribution of UK Financial Services; sixth edition', 2014, figure 19
[5] House of Commons, Standard Note 6193, 'Financial services: Contribution to the UK economy.'
[6] Association of British Insurers, 'Insurance and long-term savings: Key facts', 2016
[7] EY, 'Motor insurance market reports an underwriting loss in 2015 after two years of profits', 2016
[8] The London Market is the name given to the UK specialty insurance industry. For historic reasons firms have based their head offices in a cluster close to Leadenhall Market in London, but have operations across the UK.

constitutes the leading global centre of expertise for specialty (re)insurance. London is the only (re)insurance hub in the world where all of the world's twenty largest international (re)insurance companies are active.[9] The market acts as a platform for European and other international firms to access a global client base and expertise. It provides (re)insurance policies for corporate clients, and cover for risks such as marine, aviation, transport, energy, catastrophe and cyber. It employs an estimated 52,000 people, of which around 17,000 are outside London, but contributes around 26% of the City of London's GDP and the majority of the insurance sector's exports, according to sector organisations.[10] The market has grown at an annual rate of 1.8% over the last few years, and 66% of its income is from outside the UK and Ireland: around 14% from the rest of Europe, 34% from the US and Canada, and 18% from the rest of the world.[11]

11. In the London Market, operating cross-border or on a branch basis is the dominant model for firms active in both the EU and UK, although fly-in-fly-out advisory services are also provided. Many EU firms operating in the London Market branch into the UK and base their relevant specialist teams in London, while most London Market firms incorporated in the UK operate cross-border or via branches into the EU. This is because these firms' business models rely on a concentration of underwriting expertise and capacity in London, in order to be able to cover highly specialised risks on a pan-European or global basis.

12. The market structure also means that brokers play a particularly important role. The product development chain can be complex, with potentially an EEA local broker dealing with a London Market broker, who then builds a product across many London Market insurers and/or syndicates. This insurance product will then be reinsured, either on a direct insurer to reinsurer basis or involving one or more specialist reinsurance brokers

Gibraltar

13. Gibraltar has established itself as an offshore insurance hub for certain lines of business. There are around 50 insurance companies operating in Gibraltar – including captives (i.e. internal insurance companies used by large corporates to self-insure risks), protected cell companies, liability insurers and property insurers. The provision of motor insurance is notable, especially doing business in the UK market.

Pensions

14. Life insurers manage the majority of the UK's pension assets, but a further £2.2trn are held in occupational pension schemes.[12] These are trusts linked to an individual

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[9] City UK, Key Facts About the UK as an International Financial Centre, 2016
[10] London Market Group, London Matters, 2017
[11] London Market Group, London Matters, Figure 10, 2017
[12] The Investment Association, 'UK institutional client market', 2017

employer, which invest assets on behalf of the employees in order to pay them pensions when they retire. The overwhelming majority of occupational pensions operate domestically and so are largely unaffected by UK-EU trading relations[13]. Of the cross-border schemes operating in the UK, the majority relate to the UK-Irish border.

The current EU regulatory regime

15. The two key pieces of European legislation affecting the insurance sector are:

The Solvency II Directive

16. The Solvency II directive is a harmonised system of regulation of the risks facing insurance companies. Solvency II's main provisions concern insurers' risk management systems; the capital needed to ensure solvency; reporting; and coordination between national regulators.

17. Solvency II's market access rules allow an authorised EEA insurer to conduct business anywhere in the single market on a cross-border basis (i.e. with no local presence). To do this, they need only notify their home and host regulator. 220 UK insurance companies hold a passport to conduct business in the rest of the EEA and 726 insurance companies hold a passport to trade into the UK from the rest of the EEA.[14] In contrast, the directive requires non-EU insurers seeking to operate in the EU to establish a branch in each country or establish an EU subsidiary. This is subject to the permission of the national regulator who can impose requirements as they see fit.

Third country equivalence

18. Solvency II includes a third country equivalence regime for (re)insurance. Solvency II equivalence is a judgement about a third country (non-EEA) prudential solvency regime. It applies to three areas:
    - Reinsurance: where third country rules are considered equivalent reinsurers from those third countries must be treated in the same way by EEA supervisors as EEA reinsurers. This enables EEA insurers to enter into reinsurance contracts with third country reinsurers without local supervisory authorities demanding extra collateral is located locally.
    - Group solvency: for an insurance group headquartered in the EEA with a subsidiary in a third country, the third country regime may be used to calculate the subsidiary's solvency requirements. This does not permit cross-border access for the home company, and does not guarantee any right to establish local offices.

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[13] European Insurance and Occupational Pensions Authority, '2016 Market development report on occupational pensions and cross-border IORPs', 2016

[14] Financial Conduct Authority, 2016: https://www.parliament.uk/documents/commons-committees/treasury/Correspondence/AJB-to-Andrew-Tyrie-Passporting.PDF

- Group supervision: for an insurance group headquartered in a third country with an EEA subsidiary, the EEA regulator may rely on group supervision exercised by the third country supervisor.

19. Gaining equivalence is partly a technical question of whether the home country's regulation provides a standard of consumer protection equivalent to Solvency II, but the decision is also subject to potential objection by the Council and the Parliament. Only Switzerland and Bermuda currently have full equivalence and the regime is new (since 1 Jan 2016) so it is hard to state precedents.

20. Solvency II also includes provisions which permit the EU to enter into an agreement with a third country. Article 175 allows the EU to enter into an agreement regarding the means of exercising supervision over third country (re)insurers conducting business in the EU, and EU reinsurers conducting business in that third country. This is a form of mutual recognition . Article 171 of Solvency II permits the EU to enter into an agreement with a third country regarding certain requirements applying to EU branches of that third country (re)insurer. Article 171 allows the EU to agree to the application of provisions which are different to those otherwise required under Solvency II for the purpose of ensuring, under conditions of reciprocity, adequate protection of policyholders.

The Insurance Mediation Directive

21. The Insurance Mediation Directive (to be replaced by the Insurance Distribution Directive) establishes some high-level principles for the conduct of insurance intermediaries. It requires that insurance brokers operating in the EU are registered and disclose certain information to consumers, though enables wide discretion on how those requirements are implemented by national regulators. In practice, regulation varies between member states, from a registration requirement to detailed consumer protection rules (as in the UK). The directive specifically excludes commercial (business to business) activity from the strictest standards. The market access provisions also guarantee a right for brokers to sell cross-border or to establish local offices. To do this, they need only notify their home and host regulators. 2,758 UK insurance broking companies hold a passport to conduct business in the rest of the EEA and 5,727 insurance broking companies hold a passport to trade into the UK from the rest of the EEA.[15]

Third country equivalence

22. For brokers, neither the Insurance Mediation Directive nor the Insurance Distribution Directive that will replace it, contain a third country equivalence regime.

Cross-sectoral European Regulation

23. Cross-sectoral European Regulation is also important to insurers. Data protection is relevant because insurers need to exchange personal data for underwriting. The mobility of workers is relevant because of access to talent and the significant

[15] Financial Conduct Authority, 2016: https://www.parliament.uk/documents/commons-committees/treasury/Correspondence/AJB-to-Andrew-Tyrie-Passporting.PDF

contribution of foreign companies, particularly to the London Market. Industry views on these issues are set out below.

24. In terms of pensions regulation, the EU's **Institutions for Occupational Retirement Provision directive** (known as IORP) establishes a governance and regulatory framework for pensions schemes. Specific rules are decided nationally, in the UK by DWP and The Pensions Regulator. A revised version of the directive is likely to come into force in October 2018, with a similar approach.

25. The right of pensioners of cross-border schemes to receive their pensions without discrimination is theoretically dependent on protections established in EU law[16]. In practice, many of the relevant matters are handled on a bilateral basis. For example, the UK has a set of arrangements for 'qualifying recognised overseas pension schemes' (QROPS)[17].

Existing framework for how trade is facilitated between countries in this sector

26. The arrangements described in this section are examples of existing arrangements between countries. They should not be taken to represent the options being considered by the Government for the future economic relationship between the UK and the EU. The Government has been clear that it is seeking pragmatic and innovative solutions to issues related to the future deep and special partnership that we want with the EU.

27. On a global level, numerous WTO members make commitments in line with the WTO's Understanding on Commitments in Financial Services[18] allowing certain specialist products such as marine insurance, aviation insurance, goods in transit insurance and reinsurance cover to be sold cross-border. However, several EU Member States have reservations in these sub-sectors[19]. Similar commitments (and reservations) are also contained in some bilateral and regional trade agreements. In certain countries, including some EU member states, these have been supplemented in practice by national exemption regimes, which permit further cross-border trade in limited circumstances, such as in relation to sophisticated counterparties.

28. The EU has also established bilateral agreements for non-life insurance with Switzerland and for certain types of (re)insurance with the US. The EU-US "Covered Agreement",[20] as it is called, is an example of an agreement entered into under Article 175 of Solvency II (mentioned above). Under specified conditions it eliminates local presence requirements, collateral requirements; enables group supervision to

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[16] For example, Council Directive 98/49/EC
[17] See https://www.gov.uk/government/collections/overseas-pension-schemes
[18] https://www.wto.org/english/tratop_e/serv_e/21-fin_e.htm
[19] For example, see GATS/SC/31/Suppl.4/Rev.1 for EC12 financial services commitments and reservations
[20]https://www.treasury.gov/initiatives/fio/reports-and-notices/Documents/US_EU_Covered_Agreement_Signed_September_17.pdf

be conducted solely by the group home supervisor; and sets out mutual support for the exchange of information between supervisory authorities. The EU-Switzerland agreement on direct insurance other than life assurance[21] broadly enables direct general insurers to establish a branch in EU member states, but does not give passporting rights across the EU as a whole.

29. More widely in financial services, there are well-developed principles at the international level which seek to support cross-border activity and avoid duplicative regulation and fragmentation.

Sector views

[This information was provided by the Government to the Committee, but the Committee has decided not to publish this section]

[21] http://ec.europa.eu/world/agreements/downloadFile.do?fullText=yes&treatyTransId=549