

## There is life after Brexit

In the eve of the EU Referendum I published a briefing note about the potential Brexit impact on the Gibraltar insurance industry (entitled "*what could Brexit mean?*"). This update is intended to provide further commentary now that the vote is over.

There is no reason to believe that following the resignation of David Cameron as Prime Minister, his successor will not put in motion the formal process for the UK's exit from the European Union. That formal process will commence with the UK's notification to the European Council of its intention to withdraw in accordance with Article 50 (the exit clause) of the Treaty. It is important to emphasise, however, that EU law does not immediately cease to apply in the UK (or Gibraltar) as a result of the outcome of the Referendum. Following the notification, the UK Government has two years within which to negotiate its exit arrangements with the EU. It is impossible to predict with certainty what terms will, or indeed can be agreed, and in particular whether an EEA-type agreement could be negotiated between the EU and the UK giving the UK (including Gibraltar) continued access to the Single Market.

We also do not know how the political crisis in the UK will play out. If the Scottish Parliament passed legislation declaring the Article 50 notification illegal as contrary to the wishes of the majority of its people and null and void in Scotland, what effect would that have on UK exit negotiations? What if a UK General Election was called before Article 50 was invoked? If the Labour Party asked for and got an electoral mandate to remain in the EU, the new UK Government would have democratic legitimacy to annul the Referendum result; this possibility cannot be discarded entirely.

In the absence of certainty, however, and given that the process does envisage that the UK is leaving the EU, companies will need to review their current position and how their businesses could be impacted by EU law rights ceasing to apply post the transition period. Below I explore some of the options and possible outcomes, with the *obvious*

*caveat that this is my own personal opinion and does not constitute legal advice.*

**Gibraltar insurers writing UK business only - business as usual:**

There is no reason to believe that insurers (including captives) writing UK business under a Solvency 2 regulatory framework will be asked to cease to do so by the UK Government in the future. Gibraltar has considerable political goodwill in the UK, and no doubt local past and present politicians will leverage the relationships built in the UK over many years to ensure this is the case. This was discussed in my previous article. This also appears to be the Government of Gibraltar's position and companies should take comfort from this. It is therefore highly unlikely that the current trading relationship between the UK and Gibraltar will be affected.

**Gibraltar companies writing EU (i.e. non-UK) business:** These are the companies that will be primarily affected by EU law ceasing to apply in the UK and Gibraltar. Once the UK ceases to be part of the EU, these companies have a number of options open to them, namely, using an EU fronting arrangement (although this is unlikely to be a commercially attractive option for most carriers), seeking a licence at local level in each member state where business is written (again, unlikely to be commercially attractive), or finally, relocate from Gibraltar back into the EU. The latter is the most likely option which Boards of Directors would be considering. However, the essential point to make at the present time is that there is no immediate need to take decisions as companies should have the benefit of the two year transition period, unless exit discussions are concluded in advance of this time-frame. Whilst it is also possible that these negotiations between the UK and EU could take longer than two years, this is now unlikely given the EU clearly wants to put an end to the uncertainty created by Brexit in the rest of the EU. The other point to make, of course, is that during the two year transition there is the risk that other member states might follow the UK with their own referendum, in which case, the EU Treaty might itself not survive in its current form. Companies should therefore allow the political dust to settle before taking any decision on relocation; there is no need for hasty decisions.

**Gibraltar captives:** Gibraltar only has a handful of captives so the impact of Brexit would not be significant here in proportion to the rest of the industry. However, captives that write EU (non-UK) business would clearly have to consider their position in the same way as any other company writing EU business would. Interestingly, every challenge brings potential opportunities. The higher capital requirements for captives in the EU under the new Solvency 2 regime (which regime was brought into effect on 1 January 2016 throughout the EU) means that EU based captives have become capital inefficient for some owners. The options for captive owners in this situation were already fairly limited, namely, relocation of their captives outside the EU (eg Guernsey) and using fronting arrangements where the lower cost of capital makes it more economical for them to do so. A post-Brexit scenario therefore gives rise to a future opportunity for Gibraltar in an area where we would not otherwise have been able to compete for business under the current EU rules. Of course, for this to happen Gibraltar would require a new legislative framework to permit captive owners to set up captives in Gibraltar with less burdensome capital requirements similar to, say, Guernsey. The current legislative regime in Gibraltar (which implements EU rules) is wholly unsuitable for this. I can also see a real boost in the use of Gibraltar protected cell companies by captives in such a scenario. In this regard the sooner the UK negotiates with the EU the better it would be for Gibraltar (indeed, the UK itself) as it would end any uncertainty and both the UK and Gibraltar can plan accordingly.

**Prospects for the future:** Gibraltar's professional community is known for its resilience. We have been here before. I helped to draft the relevant legislation that opened the way for the insurance sector to develop in Gibraltar in 1997 and was also involved in advising the Financial Services Commission on the practical implementation of the "insurance passport". Back then there were less than a handful of insurance companies locally, most of them captives. The industry did not take off in earnest until 2001 when the catalyst for the exponential growth was confidence in Gibraltar's ability to deliver the necessary professional and regulatory support. At its highest there

were around 100 insurance entities in Gibraltar if one includes cells of protected cell companies. That growth slowed down in 2011 as the time horizon for the implementation of the EU Solvency 2 regime became clearer. In some respects the perception was that the advantages for the previous catalyst for growth had largely disappeared. Further, it has become apparent to many of us working in this sector that some EU rules (for example, requirements for public disclosure or the capital treatment of loan-backs for captives) were illogical, burdensome and/or time-consuming, and that more broadly in the financial sector, stifled innovation. There was also the risk of the ever changing regulatory landscape within the EU leaving the European insurance industry shrinking to greatness; in the long term that would have left the Gibraltar insurance sector without a critical mass, at worst, and under threat at best.

In the current situation, whilst it is impossible to predict with certainty, the possible outcomes are that both Gibraltar and the UK end up entirely outside the EU without bilateral trade agreements (*highly unlikely*), inside the EEA or with an equivalent status (*more likely*), or a scenario in which the UK negotiates trading relationships for itself with the EU that does not include Gibraltar (*less likely*). Avoiding the last scenario will clearly be where the most focus will go into on the part of Gibraltar. Machiavellian notions of politics aside, there is certainly a compelling moral (perhaps too even legal) argument that Gibraltar should retain its current EU terms in any EEA-type arrangement. I do not develop the legal arguments here as this is unnecessary, would probably be unhelpful for Gibraltar at this stage, and given that no doubt Scotland herself will test the legal waters on this issue at the appropriate time. Suffice it to say that having studied legal developments across multiple jurisdictions over many years I have come to the conclusion that courts often will, in given cases, develop legal principles based on 'political' considerations (rather than established law).

**European Economic Area or Solvency 2 equivalence:** If the UK can remain part of the EEA (which includes all member states and Norway, Iceland and Lichtenstein), together with Gibraltar (which is already part of the Treaty of Accession by virtue of UK membership),

then Solvency 2 would continue to apply to both Gibraltar and UK insurers as part of the Single Market. This would clearly be the best outcome for all sides as it would retain the *status quo* in the existing trading relationship. Admittedly, it is made much more difficult by the 'Out' campaign putting the question of immigration at the centre of the Referendum debate. If this was not possible then access to the Single Market in insurance would depend on what other terms were negotiated, but importantly, Gibraltar already benefits from the fact that 'Solvency 2 equivalence' could be easily achieved during the transitional period and therefore local companies would fall back on 'equivalence'. Finally, a possible Brexit compromise that the EU and UK should not be quick to dismiss is allowing financial services companies with *existing* passporting rights (both ways) to continue to trade in each other's territories (including Gibraltar), or for, say, a period of 10 years. This would help to calm financial markets, would be good for consumers in both the UK and the EU and avoid job losses in the UK and Europe.

**Frontier restrictions:** This remains the single biggest issue for Gibraltar as a whole (post-transition) and the concerns were widely aired during the Referendum campaign. This, however, is significantly less of an impact for Gibraltar insurance companies than it is, perhaps, in other sectors of the economy, because fewer people working in insurance live in Spain and commute to Gibraltar. Whilst frontier issues would clearly be an inconvenience, it should not have a commercial impact on local insurance entities.

**Other considerations:** No member of the EU has ever left before and therefore this is largely uncharted territory. The financial markets have predictably fallen as a result of Brexit and so has sterling. But as the large majority of insurance premiums are sourced from the UK, the weakening of the currency is not expected to lead to a significant impact for local companies. Nor would loss of the VAT benefits arising from Gibraltar's current EU status (its exclusion from the Customs Union) cause damage to local insurers given that such benefits have already been significantly eroded anyway.

No one really knows what the political consequences of the UK leaving the EU will be in other EU countries but there must surely be a risk that Euro-scepticism will spread across Europe.

There is, however, the uncertainty of having to comply with any new EU rules during the period of transition, especially if this takes longer than expected and if it increases the regulatory burden and cost for local companies.

**What advantages could Gibraltar offer outside the EU/EEA?** I have already mentioned a special regime for captives conducting international business. That would be within Gibraltar's legislative competence. The other is a new regulatory framework that encourages non-UK/EU financial services businesses to set up in Gibraltar underpinned by regulatory ease of access, speed to market and a more pragmatic approach in certain areas than is currently available under EU rules.

Further, those of us that have been involved in the insurance sector from its humble beginnings have seen not just the entire insurance cycle but also the development of the industry through its various phases. At times a catalyst for growth was the simple expedient of a promoter seeking to set up an insurance company with the commercial imperative of having to be licensed within 10 weeks. Regulator and advisers pulled together to achieve the client's strategic objective and that one success then had a multiplying effect through what I have often described as the 'herd instinct'. I have seen this corporate pattern of behaviour on numerous occasions throughout my career - a new entrant to the market resulting in other companies following shortly after. I therefore have no doubt Gibraltar can repeat these historical successes in the new commercial environment it now finds itself in.

Aside from captives where the expectation would logically be for local insurance managers to manage captives, I can still see increased employment growth within the sector, especially among Gibraltar insurers writing UK business (which is largely the focus of the industry today) as companies continue to grow staff numbers in line

with their business plans. At the same time, the FSC is making it clear that any new insurance companies (non-captives) must commit to a real management presence locally. This should help increase employment prospects further and in any event is consistent with the expectation of foreign tax authorities for companies to be managed and controlled locally. There are good quality jobs in insurance and all local stakeholders must continue to work together not just to keep what we have already but indeed to grow the sector.

A key jurisdictional strategy in insurance for Gibraltar therefore has to be developing new captive/international (re)insurance business opportunities, especially in the area of protected cell companies, that does not rely on the EU status, whilst retaining the existing trading relationship with the UK. The continuation of EU (non-UK) trading rights is, however, as I have pointed out, largely outside Gibraltar's control.

**Should companies do anything now from a governance perspective?** Yes, companies should set up a committee within their existing governance structure to monitor closely the exit process as we move forward and also take professional advice.

**Concluding remarks:** Brexit does not represent doom and gloom for the Gibraltar insurance industry. Far from it. It simply means the sector needs to partially reposition itself. Admittedly, those companies that write EU (non-UK) business will face uncertainty but the option of relocation to another EU jurisdiction would still be open to them when some clarity emerges. Other than keeping the situation under review, there is not much more affected companies can be expected to do in the short-term as the timeline for negotiations between the UK and the EU is two years and may even take longer. A key significant issue for Gibraltar in a post-Brexit scenario would also be the direction of future local regulation, in particular, ensuring proportionality for captives or companies seeking to write non-UK/EU business and significantly reduced authorisation times for new entrants in the market compared to other jurisdictions. Both are plainly within our gift.

I first became involved in insurance many years ago when there was no real local industry, and, along with others, helped grow a sector that has contributed to many local jobs and tens of millions in Government revenues. When we started, our business model was a blank piece of paper with three simple words - *"innovation, entrepreneurial and opportunistic"*. The ingredients for success were not rocket science and can be replicated. What we cannot and will not do is fall into a legal and regulatory vacuum over the next 2 years where the jurisdiction suffers death by a thousand cuts even before leaving the EU. *We therefore have to move forward and our response to these changing times must be one of pragmatism measured in months, not years.*

**Postscript:** Bankers were widely blamed by politicians and public opinion in the UK for causing the 2009 banking crisis and a raft of regulations followed to prevent this happening again. Misconceived notions of democracy/sovereignty and politicians miscalculations have caused the current UK political, constitutional and economic crisis. What happens now?

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