The impact of Brexit on the insurance industry

On 23 June 2016, some 72.2% of British people took part in a momentous vote on whether to leave the European Union. The result was close but unexpected – some 51.9% chose leave, while 48.1% wanted to remain. The shockwaves are still being felt – not least by many in the insurance sector.

There is undoubtedly much at stake since the UK is the third largest insurance and long-term savings industry in the world and the largest in the EU.

It is clear many felt leaving would create volatility and uncertainty and with so many leading insurers having strong connections with Europe, an isolationist route made little sense.

So, along with the Bank of England, the then Prime Minister David Cameron and the present incumbent Theresa May, along with a host of economists, the insurance industry largely favoured remaining.
We heard from the ABI, BIBA and Lloyd’s in depth about why it made sense to stay. But, despite so many speaking out in favour of remain, the message didn’t resonate with voters strongly enough.

However, there is no point in looking backwards – members of the UK insurance industry, like everyone else, are now Brexiteers and the message is about finding opportunities as well as raising concerns. There may well be scope to do more business globally and for insurers to respond to customers’ changing needs. For example, there could be more demand for trade credit insurance if there are fewer EU protections so small and medium-sized enterprises (SMEs) might seek additional services such as legal guidance alongside their insurance as the UK’s regulatory and legislative framework adjusts.

Negotiations are scheduled to last two years after the triggering of Article 50, which sets out the process by which members can leave the EU. It will be full steam ahead as we know 29 March 2019 is seen as the likely leaving date – there can only be an extension of negotiations if all members agree to this.

So the impact is yet to be realised on the deal that needs to materialise.

The gung-ho tones of Nigel Farage are muted as is the view that “no deal is better than a bad deal” which Theresa May had suggested. Many will be hoping lead negotiator David Davies’ efforts will result in a softer landing than some were preparing for.

But, even if the mood is less confrontational, a very different UK will eventually emerge and the insurance sector is exposed to a range of new threats as well as the opportunities. So what kind of changes should we expect to see?
Passporting is a key issue for underwriters

The number one issue concerning many underwriters is that of access. Presently, UK insurance firms benefit from direct access to a single insurance market covering 28 countries with some half a billion people.

Passporting was put forward as one of the biggest reasons for remaining in the EU as it allowed insurers to conduct cross-border in the European Economic Area without requiring further authorisation or incurring additional local costs.

Losing this right could be problematic for insurers. We don’t know if the UK’s negotiators will be able to secure ongoing passporting rights or if an arduous and expensive country-by-country approval process will be required.

Pundits are outlining a few options. Firstly, the UK could stay within the single market, probably by joining the EEA – this would be along with other EU countries and also Iceland, Liechtenstein and Norway. However, for the UK as a whole, this is likely to be an unpopular choice since it also means accepting the free movement of people and rulings from the European Court of Justice along with contributing towards the EU budget – antipathy towards these were a driver for the ‘leave’ vote.

Alternatively, UK businesses could establish subsidiaries within the EU and this would allow passporting rights – Dublin is one city hoping to benefit.

Clearly, this is not so much of an issue for large organisations or where subsidiaries already exist, but it would be impractical and too costly for some.

Meanwhile, equivalence is also being mooted and this means allowing cross-border trading agreements where countries recognise each other’s regulatory standards. This can appear an attractive model but it is not without issues. Critics say equivalence deals can be easily revoked and there can be less certainty.

So what will happen with passporting is an important issue, ratings agency Moody’s has said the risks will be ‘manageable’. The ABI, the Lloyd’s Market Association and Lloyd’s directly will be continuing to lobby hard to ensure there are workable solutions and that Brexit does not result in our insurance sector being weakened.

No one is saying that Europe is unimportant – clearly it is, but there are also pro-insurance voices saying there will be more scope to do business globally once Brexit is complete. The MP for the City of London and Westminster, Mark Field, is among those taking a bullish approach to Brexit, pointing out that our insurance market should be looking further afield at territories such as Singapore, Qatar, Dubai and Bermuda as these present exciting export opportunities for the UK.

Still, there will always be detractors and Sean McGovern, who was then chief risk officer at Lloyd’s, said last year, “We must recognise that, if the UK leaves the EU, other countries may show less appetite for making agreements with a UK of 63 million customers than they do with an EU of 500 million customers. Negotiations to replace EU trade deals would take years, without any guarantee that we would get the same quantity or quality of deals. Moreover, the UK would not jump to the front of the queue – other countries are already busy working on deals, including with the EU.”

Even so, while some have claimed that EU negotiators may want to ‘punish’ the UK, it is also worth remembering that European insurers will still want to trade with the UK and they will not want to lose access. This is a key reason why some type of mutually beneficial deal may result.
Costs linked to Brexit and maintaining profitability

Markets do not like uncertainty and with so much surrounding Brexit, it is not surprising that some insurers are currently keeping their heads below the parapet.

Following the referendum results, many insurers were hit with falling share prices. This was the time to start contingency planning and to state firmly that it was “business as usual”. But, even in practical terms insurers will be faced with additional cost simply through having to redraft wordings and change literature, documentation and websites to reflect their new non-EU status.

Sterling’s value has also dropped and correspondingly raised insurers’ costs. While absorbing this, Brexit also requires insurers to make business decisions about whether they need to set up new or additional European hubs. This of course is additional expense, although new operations can also certainly start out on a small scale.

The other side of the coin is that as sterling loses value, the UK becomes cheaper for overseas customers. This is potentially exciting and so a goal must be to attract more business, showing that we have the superior products and services that cannot be found elsewhere. Supporters of Brexit say the UK can take off the EU membership shackles and regain our reputation as the undisputed market innovator.
Will there be short-term losses?

Whenever there is an economic downturn, people buy less insurance.

So if fuel costs go up, for example, then people may drive less and that will impact on motor insurance. If the cost of travel rises, then that means fewer holidays and business travel – and so of course, less need for insurance. SMEs may hold back on recruitment and premises, which will result in less liability and property cover.

Along with keeping an eye on the markets, a close watch will also need to be kept on prices and inflation. Again, it may not be all bad news and it could also prompt more to buy British, but also, so far the economy appears pretty resilient. Unemployment is relatively low and there are absolutely no signs of an imminent collapse.

Economic optimism is tempered but there is also no panic, Catherine Thomas, senior director of analytics at AM Best, said,

“AM Best does not expect to take rating actions as a direct consequence of Brexit. However, increased economic and regulatory uncertainty, as well as the potential for higher barriers to trade, overall, is a credit negative for the UK insurance industry.”
Deal or no deal?

In terms of surviving or even thriving after Brexit, we need to know the details of the deal and see how business needs and consumer habits could change.

For example, Deloitte looked at the massive German car manufacturing market and the impact of Brexit with no EU-UK trade deal. It said this would imply the introduction of World Trade Organization tariffs on imports – for the car industry that would mean a 10% tariff on vehicles and a 4.5% tariff on car parts.

While this is bad news for someone wanting a BMW, home grown cars or those from markets where trade agreements are reached could surge instead. Alternatively, a free trade agreement would mean the tariffs are not imposed and the UK remains an important market.

Jobs – winners and losers

Certainly within the London market, there are many skilled EU nationals working here. It is reassuring that the prime minister has emphasised that overall, many workers will be entitled to stay, but we do not know if they will choose to do so or if the economy stalls, that there will even be enough work for them.

But let’s also remember that the UK insurance sector is a major employer, with around 300,000 people working in it and in recent years, a growing emphasis on developing professionalism. Could this also be good news for workers? It may be positive in terms of British talent, but also result in less diverse workplaces.

Conversely, it’s possible that if there is widespread relocation to Europe then some jobs in the UK could be vulnerable. One report from consultant Cicero said up to 48,000 jobs could be at risk if insurers chose to relocate in event of Brexit.

Yet simply blaming Brexit is short-sighted. Insurance jobs can be under threat for many different reasons. Knowledge and skills will count for much and offer UK workers their best defence in a changing environment.
Effects on claims

Until we know the outcome of the negotiations and indeed how sterling reacts, there can only be educated guesswork as to the impact on claims and correspondingly, premiums.

But, where goods need to be imported – such as foreign car parts – we can surmise that there could be a rise in the cost of motor claims. Of course, it is not just motor, a property claim could also require imported materials or tools. Businesses holding large amounts of imported stock may also need to revisit their sums insured. It could depend too on where the stock is coming from and this may also impact on business interruption.

A further issue for insurers is the cost of repairers. For example, there is a shortage of car technicians and builders and maintenance staff – and if some of these roles are filled by Europeans and other immigrants and they choose to leave the UK – then this may mean higher wages and costlier claims.
Regulation favours remain

A repeal bill recently passed that allows the UK to replace EU legislation – but it also looks likely that some European law will be staying.

And according to law firm Kennedys, “The UK government has confirmed that it does not want a regulation bonfire, suggesting that it will want to keep current regulatory regimes as intact as possible post-Brexit. This will come with ease for applicable EU regulations where there is a UK equivalent.”

It added, “The Motor Insurance Directive that was transposed into UK legislation, as well as the firmly established compulsory motor insurance, are likely to remain.”

Further, Solvency II came into force in January 2016, requiring many insurers to put in a vast amount of effort and money into working with consultants, modelling and implementing new systems.

The regulation is aimed at protecting policyholders by aligning insurer’s regulatory capital requirements to their risk profile. While the government was lobbied by insurers who claimed the regime was excessive and costly, there is also the fact that with so much investment made into Solvency II, dismantling it would be damaging and could impact on trade.

Likewise, Solvency II would almost certainly need to be in place should the UK stay in the EEA. But, there may be some tinkering around the edges and the ABI has said it supports Solvency II remaining but with some reform.

It suggested changes could occur that would not impact on “the UK’s ability to seek equivalence.” These include reducing the risk margin, which it said is too large, and makes some products such as annuities overly expensive. The ABI added that there should also be greater investment flexibility allowed, such as insurers being able to invest in infrastructure projects. Finally, it called for more straightforward reporting requirements, which would also reduce costs, in particular for small and medium-sized insurers.

Meanwhile, Jacqueline Fenech, director with consultants Protiviti, said Solvency II "is fast becoming an international insurance regulatory standard with regulatory authorities outside the EU, such as the Monetary Authority of Singapore.” For this reason, she added, “Solvency II is not just an EU regime, but increasingly a global one...it would be reckless for UK insurers to bail out.”

Likewise, the government stated that the General Data Protection Regulation was coming in 2018 despite Brexit. This tough new law is about modernising data protection laws and the UK will be taking it on board, despite the repeal bill. There is broad agreement that a more responsible approach to data privacy is needed and the way companies manage data is under scrutiny, particularly given recent cyber attacks. Being outside of the EU is unlikely to allow this regulation to be ignored, since all non-EU organisations targeting EU citizens with goods or services must abide by the rules when they come into force next year.
Where could EU laws change?

There is no doubt that having laws set in Brussels has been a frustration for some. Following the EU Gender Directive, which came into force in 2012, insurers could no longer offer women more favourable motor insurance terms. Instead, insurers began using other information to gauge risk, such as telematics, but this directive could be one that is eventually shelved.

Some core insurance issues are already underway irrespective of leaving the EU. Bogus whiplash claims remain on the agenda and were included in the Queen’s Speech, with claimants to be subject to a cap and being required to produce medical evidence. Implementation is unlikely though until 2018/19.

But, it has been reported that changes to the discount rate – introduced by the Lord Chancellor – will negate any whiplash savings. So, this remains a major challenge for the industry and despite the background of Brexit, securing a fairer formula that works for claimants and insurers is set to remain a lobbying priority. Perhaps in a bid to ensure insurers remain profitable and competitive, the government will seek to revisit this and introduce reform.
Consumers need clarity

Even those who voted for Brexit would not have known exactly how things will pan out. The result of the General Election adds even more uncertainty to the mix. But there are certainly many questions that will need answering when it comes to insurance.

Take travel insurance for example. David Davies has said he believes the EU-wide system of healthcare will remain, yet there is no formal agreement. But without this, there are quite legitimate fears that premiums will rise. If it is not possible for state hospitals to treat Britons, then private clinics will be used instead, resulting in more expensive claims.

Meanwhile, there are signs of a property slowdown and it was reported by the National Association of Estate Agents recently that three quarters of homes were sold for less than the asking price and that there has been a rise in the number of homes for sale. This could have some impact on insurance, even though when it comes to household, buildings cover is based on rebuild rather than actual values. But, landlords may see more voids if they are housing EU citizens or other overseas nationals who choose to leave the UK.

Riding the storm

The Brexit result presents the UK with many unknowns that the risk averse insurance industry most now prepare for.

We know there are going to be positives and negatives and that the need for insurance will remain – indeed, it may be deemed even more necessary in some cases. “Brexit means Brexit” has been the mantra – for insurers, let’s hope the deal we get allows the industry to prosper in our newly independent state.