CAA COMMISSARIAT AUX ASSURANCES

Luxembourg, 8 April 2020

Briefing note 20/11 on the impact of Brexit on implementation of circular LC 15/3*

This briefing note examines the consequences of a no-deal Brexit containing specific provisions for financial services on implementation of the provisions of circular LC 15/3 covering the investment rules for life assurance products linked to investment funds.

It should be noted that unit-linked policies may only invest in external or internal collective funds, whether dedicated or specialised, and it is therefore appropriate to separately review the impact of Brexit on these different categories of funds.

1. External funds

With effect from 1 January 2021, direct investments in external United Kingdom funds must be treated as investments in external funds of a country in OECD Zone A outside the EEA. They may therefore only be exploited up to the maximum level of 25% in terms of UCITS or open-ended alternative funds of funds, and 0% for all other types of funds. The utilisation rule up to the ceiling set out in the local legislation of the policyholder - even British policyholders - may only be exploited for open-ended real estate funds, as for all other funds the rule is only to be applied for funds domiciled in an EEA country.

Dependent territories of the UK are no longer territories dependent of an EEA country and external funds domiciled in such territories, whether UCITS, alternative funds or any other type of fund, may no longer be exploited. The utilisation rule up to the ceiling set out in the local legislation of the policyholder - even British policyholders - may also no longer be exploited, as such rules only apply to funds domiciled in territories dependent of an EEA country.

For policies entered into on or after 1 January 2021, any investment above the aforementioned limits is unauthorised.

However, for policies entered into before 1 January 2021, the change of status of the UK and its dependent territories has no automatic impact on external funds underlying such policies.

In the first instance, this position complies with the position adopted at the time of previous changes to investment rules for unit-linked policies which have never applied to existing policies without any explicit new action being taken by the policyholder.

The new investment rules could subsequently conflict with the general or special conditions of the policy. This would apply, for example, to a policy where the general conditions allow for the investment of premiums, including future premiums, in a set of funds stated on a list submitted at the commencement of the policy yet without enabling the insurer to subsequently apply restrictions to the list.

Even in the absence of formal provisions, the CAA deems that the investment rules in existence when taking out the policy and notified to the policyholder form part of all the provisions on the basis of which the policyholder has given their approval. Any modification during the term of the policy would breach the duty of good faith which must govern the execution of all policies.

Any retroactive application of ineligibility or restricted eligibility conditions to fund units held in the portfolio before 1 January 2021 would raise the question of compliance with the policyholder's decisions, always assuming that the assets of the portfolio were selected in compliance with circular 15/3 and in accordance with the investment policy defined by the client. Their inclusion and maintenance within the policy form part of the rights and obligations emanating from the policy.

For all these reasons, the CAA deems that the investment rules applicable on or before 31 December 2020 shall continue to apply even after this date for all ongoing policies.

However, the CAA also deems that the new classification of UK funds for new policies with investment thresholds consequently revised downwards constitute for holders of ongoing policies an important factor in the assessment of the investment risks, and must therefore be notified to such policyholders. Such notification should be accompanied by a proposal to switch to one or more EEA vehicles offering investment strategies similar to those of UK funds or of its dependent territories within the portfolio. It is also permissible to offer at the same time full application of the post-Brexit investment rules taking into account the new status of the UK and its dependent territories.

Should you not reply to, or reject this proposal, the pre-Brexit rules shall continue to apply to ongoing policies. The insurance company may notably not refuse to maintain UK fund units or to acquire further such units on the sole basis that the thresholds of the post-Brexit regime would be exceeded.

2. Internal collective funds

Regarding investments in internal collective internal funds, issuers located in the UK are to be treated as issuers of a Zone A OECD country from 1 January 2021, and those of dependent territories of the UK are to be treated as issuers outside Zone A of the OECD.

Internal collective funds created on or after 1 January 2021 must treat the securities issued by UK issuers or issuers of its dependent territories in line with the classification of the country and its territories.

Internal collective funds created on or before 31 December 2020 may continue to be managed under the pre-Brexit classification, but may only be used as a vehicle for insurance policies which were themselves created before the aforementioned deadline.

Where a internal collective fund created on or before 31 December 2020 is also to be used as a vehicle for policies issued after this date, its investment policy must be adapted in advance.

This gives rise to 3 possible scenarios.

Firstly, the new policy remains compatible with the description previously provided by the policyholder. To avoid any subsequent dispute, in such cases the CAA recommends the situation to be communicated to both the relevant policyholders and the CAA.

Secondly, the new policy is no longer compatible with the description previously provided by the policyholder, but is possible under subparagraph 5.1.4 of LC 15/3. The provisions of this subparagraph must then be complied with, including those relating to the change being notified to the CAA.

Lastly, the new policy is no longer compatible with the description previously provided by the policyholder and is not possible under subparagraph 5.1.4 of LC 15/3. In such cases, the previous fund must be maintained for existing policyholders and a new fund must be established for new policies.

3. Internal dedicated funds or specialised insurance funds

Regarding investments in internal dedicated funds and specialised insurance funds, issuers located in the UK are to be treated as issuers of a Zone A OECD country from 1 January 2021, and those of dependent territories of the UK are to be treated as issuers outside Zone A of the OECD.

For internal dedicated funds or specialised insurance funds created on or after 1 January 2021, the securities issued by UK issuers or by any of its dependent territories will be treated in line with the new classification of such countries and territories. This rule shall apply independently of the question of establishing if the dedicated fund is created for a policy concluded before or after 1 January 2021.

In practice, the new status of the UK will only affect dedicated funds of types A and B, with type C and D funds able to invest without limit in all assets set out in Annex 1 of circular LC 15/3. For dependent territories, on the other hand, units of alternative funds issued by issuers located in such territories may not be considered to be covered by Annex 1 and are therefore no longer accessible by clients investing in a dedicated fund of type C. Only dedicated funds of type D may continue to exploit this possibility.

Dedicated funds created on or before 31 December 2020 must continue to be managed under the pre-Brexit classification, unless instructed otherwise by the client.

For holders of policies invested in existing dedicated funds, the CAA deems that the new classification of UK financial instruments for new dedicated funds, with investment thresholds consequently revised downwards, constitutes an important factor in the assessment of the investment risks, and must therefore be notified to such policyholders and their asset managers, as applicable. It is the responsibility of the policyholder and their investment advisor to assess the merits of modifying the investment policy.

For the Management Committee

Claude WIRION,
Director

*Please note that this document in English is a translation of the original version in French. It is for reference purposes only and the French version prevails.