INSURANCE BULLETIN
MAY 2022

In this Insurance Bulletin:

REGULATORY UPDATE

- **House of Lords Industry and Regulators Committee recommends reforms to (re)insurance regulation**
- **Solvency II: HM Treasury's consultation and review of the UK Solvency II prudential regime**
- **PRA and FCA publish business plans and strategy – key points of interest**

SUSTAINABILITY

- **Net Zero Insurance Alliance – Developments on the road to Net Zero**

FRANCE

- **Significant judgment for insurers in France on "Loi Badinter"**

Editor

WILLIAM REDDIE
Partner, London
T +44 (0)20 7264 8758
E william.reddie@hfw.com

Co-editor

KATE AYRES
Professional Support Lawyer, London
T +44 (0)20 7264 8120
E kate.ayres@hfw.com

FRANCIS WALTERS
ASSOCIATE, LONDON

"Among the differing views heard from industry participants and the PRA and the FCA, a common theme was the competitiveness of the London Market's regulatory framework."

REGULATORY UPDATE

House of Lords Industry and Regulators Committee recommends reforms to (re)insurance regulation

The House of Lords Industry and Regulators Committee (the Committee) has recommended reforms of regulators' statutory objectives and stakeholder panels, as well as regular reviews of their rules.

In a letter sent to HM Treasury on 6 April 2022, the Committee set out certain issues that were raised in its inquiry into commercial (re)insurance regulation. The inquiry is part of the ongoing Future Regulatory Framework (**FRF**) Review. The government launched the FRF Review, following Brexit, with the intention of ensuring the UK financial regulatory framework remained fit for purpose. Proposed changes will likely form part of a Financial Services Bill and the proposals include delegating broader responsibility for rule-making to regulators.

Among the differing views heard from industry participants and the PRA and the FCA, a common theme was the competitiveness of the London Market's regulatory framework. Industry witnesses referred to risk-aversion, inflexibility and bureaucracy in contrast to other jurisdictions like Singapore and Bermuda. The regulators said they aim to act proportionately, while being mindful of their impact on the industry.

Recommendations

Industry witnesses have argued for a new, primary competitiveness objective for the regulators. However, the Committee agrees with the regulators that their primary objective should continue to be the safety and soundness of firms, citing concerns that certain reforms could dilute the UK's robust and rigorous framework.

The Committee recognises the strong arguments in favour of a secondary competitiveness objective, but recommends establishing publicly available clear and appropriate criteria and performance measures in order to hold regulators to account.

Industry witnesses also argued that rules are sometimes applied too generally in a one-size-fits-all manner. The Committee has recommended that the regulators formalise a regular process of reviewing their rules. The focus and aim of such reviews should be on the scope for efficiency and proportionality, to ensure the regulators maintain high standards to enable the competitiveness of the industry.

Another issue which industry witnesses highlighted was a lack of open, collaborative dialogue with regulators. The FCA currently holds panels with stakeholders which practitioners say do not allow for sufficient feedback. This contrasts with the advisory panel of business leaders and academics organised by the Monetary Authority of Singapore, from which the regulator asks for feedback on policy matters. The Committee says stakeholder panels should facilitate two-way dialogue with UK regulators to allow industry participants to express their views on how the regulators are performing, as well as allowing the regulators to set out their own plans.

HM Treasury is likely to introduce the Financial Services Bill implementing the FRF Review in H2 2022.

FRANCIS WALTERS
Associate, London
T +44 (0)20 7264 8294
E francis.walters@hfw.com

WILLIAM REDDIE
PARTNER, LONDON

GAURAV JAISWAL
TRAINEE SOLICITOR, LONDON

"The PRA's view is that there are packages within the HMT consultation that would be consistent with the PRA's statutory objectives"

Solvency II: HM Treasury's consultation and review of the UK Solvency II prudential regime

Following Brexit, and as part of the FRF Review (see Francis Walters' article above) there has been long-standing discussion around changes to the existing UK Solvency II framework, and how the UK financial services regulatory framework should adapt to the UK's position outside the EU.

HM Treasury's proposed reforms and consultation paper

On 28 April 2022, HM Treasury, following responses to an earlier call for evidence in October 2020, published a **consultation paper** on its views on the existing UK Solvency II prudential regime for insurers and its suggestions for the route ahead. The headline proposed reforms are:

- a substantial reduction in the risk margin, including a cut of around 60-70% for long-term life insurers, and likely to be around 30% for general insurers;
- a reassessment of the fundamental spread used in the calculation of the matching adjustment;
- the introduction of a significant increase in flexibility in assets suitable for matching adjustment portfolios; and
- a reduction in the EU-derived regulations which make up the current reporting and administrative burden.

John Glen MP, Economic Secretary to the Treasury stated that *"these reforms will help maintain and grow the insurance sector whilst ensuring both a very high standard of policyholder protection and the safety and soundness of UK insurers"*. Crucially, the hope is that the reforms will result in a material release of potentially 10 – 15% of the capital currently held by life insurers, thus unlocking *"tens of billions of pounds for long term productive investments, including infrastructure"*. The ultimate aim is that some of this newly released capital could then be funnelled into the sector's efforts to transition to net zero.

The PRA's response

Coinciding with HM Treasury's release of their paper, the PRA **published** a statement on the proposed reforms. The PRA has also published two supplementary documents - a discussion paper (DP) **DP2/22** and a summary of the 2021 Quantitative Impact Study (QIS) **Engagements**.

In releasing its statement and the documents, the PRA relied on data gathered in the QIS, engagement with insurers and its assessment of the estimated reduction in aggregate capital levels for the insurance sector (and therefore safety and soundness and policyholder protection) that the reform options would imply.

The PRA's view is that, there are packages within the HMT consultation that would be consistent with the PRA's statutory objectives and achieve HM Treasury's objectives, provided that satisfactory reforms to the fundamental spread and risk margin are achieved.

The EU

The European Commission proposed revisions to the Solvency II Directive on 22 September 2021. Long-term sustainable investments, proportionality, supervisory coordination, systemic risk and a new regime for the restructuring or resolution of insurance companies are some of the main issues that are subject to reform. Discussions between the European Parliament and Council in relation to a draft Directive are progressing.

Next steps

The PRA's DP closes for comments on 21 July 2022. The consultation by HM Treasury also closes on 21 July 2022 following which HM Treasury will consider the feedback from the consultation before deciding which aspects of the reforms best sit in legislation and which in the PRA's rules.

WILLIAM REDDIE
Partner, London
T +44 (0)20 7264 8758
E william.reddie@hfw.com

Additional research undertaken by Gaurav Jaiswal, Trainee Solicitor, London

WILLIAM REDDIE
PARTNER, LONDON

KATE AYRES
PROFESSIONAL SUPPORT LAWYER, LONDON

"The FCA has published a three year strategy, in which it indicates its shift to focussing "more on the problem in front of us rather than simply addressing types of firm or sector."

PRA and FCA publish business plans and strategy – key points of interest

On 20 April, the PRA published its 2022/2023 business plan. The FCA has also published its own business plan as well as a Strategy for 2022-2025. Below we briefly summarise some of the points discussed within them.

PRA's business plan

The PRA sets out four strategic priorities:

- Retain and build on the strength of the banking and insurance sectors delivered by the financial crisis reforms;
- Be at the forefront of identifying new and emerging risks and developing international policy;
- Support competitive and dynamic markets; and
- Run an inclusive, efficient and modern regulator

As noted in the previous article, HM Treasury is consulting on amendments to Solvency II, and the PRA indicates that it also intends to consult in this area. For life insurers a key focus in 2022 will be to gather market sensitivity data for the largest firms to improve understanding of solvency and exposure to market movements. For general insurers there will be engagement to understand: how monitoring of economic inflation risk takes place; how general and social inflation factors into reserving decisions; the impact on cost of clams; and potential impacts on financial resilience. The PRA will continue to assess how contract certainty risk is managed in general insurance firms following the issues that arose in relation to business interruption policy response to COVID-19 related claims.

As far as climate change is concerned, the PRA will switch its approach from implementation to actively supervising against the threats. The PRA expects firms to refine, innovate and integrate climate related financial risk management practices, including dealing with the challenges of data gaps. The largest firms (and a sample of smaller firms) will be asked to prepare a report on how they have embedded the management of climate change into their existing risk management frameworks. The results of the Climate Biennial Exploratory Scenario (**CBES**) have at the time of writing just been published. This was an exercise designed to size the financial exposures of firms; understand how firms may respond to different climate scenarios and the impact on business models and provision of financial services; and assist firms in their management of the risks. The key findings include that scenario analysis is in its infancy with notable data gaps; and that although, at an aggregate level, UK banks and insurers can absorb the costs of transition without risks to solvency, the overall costs will be lowest with early well-managed action.

The PRA also intends to consult in 2022 on the longer-term approach to policymaking under the new FRF regime (touched on above).

FCA strategy and business plan

For the first time, in April, the FCA has published a three-year **strategy**, in which it indicates its shift to focussing *"more on the problem in front of us rather than simply addressing types of firm or sector"*. This indicates the outcomes to be achieved on a cross-sector basis, which are:

- Reducing and preventing serious harm
- Setting and testing higher standards
- Promoting competition and positive change.

In its **Business Plan** the FCA sets out more detail of its activities for the next year.

Reducing and preventing serious harm

The FCA intends to act faster against firms causing harm to consumers or markets. It will take steps to ensure the redress system is more timely and consumer awareness of it is increased. It intends to set rules and standards to apply greater consistency to firms so that they better understand obligations on them and harms are properly taken into account, and it will seek to identify and proactively mitigate harms using Data Dashboards. The FCA also seeks to address financial crime and deliver action on market abuse.

Setting and testing higher standards

The FCA indicates that firms need to do more to make financial services work well for consumers. Steps that will be taken include embedding the new Consumer Duty and making it an integral part of regulatory approach and mindset, and the feedback statement on the Duty and any finalised rules and guidance will be published by the end of July. The FCA also aims to embed environmental, social and governance (ESG) work to support the sector to drive change, and for example, it will publish a report in 2022 covering the recommended disclosures of the Task Force on Climate-related Financial Disclosures (TCFD).

The FCA is also working to design a new regulatory framework that transfers firm-facing requirements from legislation into the Handbook, following the FRF Review (discussed above).

WILLIAM REDDIE
Partner, London
T +44 (0)20 7264 8758
E william.reddie@hfw.com

KATE AYRES
Professional Support Lawyer, London
T +44 (0)20 7264 8120
E kate.ayres@hfw.com

SUSTAINABILITY

KATE AYRES
PROFESSIONAL SUPPORT
LAWYER, LONDON

"The NZIA's theory of change is that it is necessary for the insurance industry to support real world actions to achieve net-zero insurance targets."

Net Zero Insurance Alliance – Developments on the road to Net Zero

The Net Zero Insurance Alliance (NZIA) has published a white paper detailing its current thinking, and next steps in its mission to address the climate impact of underwriting.

The NZIA, a UN-convened alliance, was formed in July 2021, and a key aim of the current 24 members is transitioning their underwriting portfolios to net-zero greenhouse gas emissions (GHGs) by 2050, in line with the Paris agreement.

Although there has been plenty of focus on the financing of emissions (ie on investment and lending portfolios), there has been less focus on the insurance of emissions. The NZIA seeks to change this and to use insurance, in one of its roles as an enabler and influencer of activities that could not take place without insurance, to make a real-world difference to GHG emissions.

The NZIA has recently published a white paper that sets out a number of workstreams to address key challenges that arise. A few of the issues contained in the paper are discussed briefly below.

Theory of change

The NZIA's theory of change is that it is necessary for the insurance industry to support real world actions to achieve net-zero insurance targets. There are three main areas that the industry can support:

- Abatement of GHG emissions, which insurers can assist, for example, by pricing and developing products for new risks as well as working with its clients;

- Neutralisation – ie the removal of CO_2 from the atmosphere, which the industry can support by working to understand the risks and work with key parties; and
- Compensation – using insurance to manage compensation (ie the financing of abatement and neutralisation tactics) and abatement project risks.

Metrics

The NZIA has asked the Partnership for Carbon Accounting Financials (**PCAF**) to establish the first methodology to measure and disclose the GHG emissions associated with (re)insurance underwriting portfolios. This seeks to measure (re)insurers' contribution to the transition to net zero based on the type and scope of risks they insure. It is a crucial step to give insurers insight into where they are with their own transition, understand the real-world impact of their underwriting decisions, and provide transparency and comparability between different insurers.

The PCAF has published a scoping **paper**. This discusses initial challenges, such as problems with standardisation and data availability on the GHG emissions of insureds. Another key issue is how much of an insured's GHG emissions should be attributed to the insurance portfolio taking into account, for example, the fact that insurance may be related to a particular project undertaken by the insured so that only emissions related to the project should be attributed to the insurance. Another problem is double-counting of GHG emissions, for example where the insurer provides cover for the same insured across multiple lines of business or both invests in and insures the same companies. Communication of the meaning of the eventual figures produced to stakeholders, so as to ensure proper understanding of what they do and do not demonstrate, will be key.

Targets

The NZIA has indicated that it will release a target setting protocol by January 2023, and that members will have six months to set their emissions reductions targets in line with the protocol. It is working with the Science Based Targets Initiative (SBTi) which is developing a Financial Net Zero Standard that will encompass lending, insurance and investment portfolios and include qualitative and quantitative criteria to assess financial net-zero targets.

Conclusion

Moving forward with net-zero insurance undoubtedly presents some big challenges, and the industry has been clear that it must undertake the transition to net zero responsibly, and along a clear pathway.

KATE AYRES
Professional Support Lawyer, London
T +44 (0)20 7264 8120
E kate.ayres@hfw.com

OLIVIER PURCELL
PARTNER, PARIS

FRANCE

Significant judgment for insurers in France on "Loi Badinter"

Two recent judgments of the French Cour de Cassation have ruled on an issue of significance to the French insurance market.

The 1985 "Loi Badinter" introduced a new legal regime to compensate the victims of road traffic accidents. It provides that all victims (including those transported pursuant to a contract) of a motor vehicle involved in a road traffic accident, with the exception of the driver, must be indemnified by the vehicle's driver, even if they are in the wrong.

The Law in effect introduced a strict liability regime; the driver cannot rely on force majeure or third party intervention as a defence to personal injury

LOUIS CORNUT-GENTILLE
SENIOR ASSOCIATE, PARIS

"Astonishingly, this was the first time since 1985 that this issue had been ruled upon by the Supreme Court, notwithstanding the considerable volume of litigation which the Loi Badinter has generated over almost four decades."

claims. The Law included further provisions in relation to material damage arising.

In the matter most recently considered by the Supreme Court, a cargo owner had concluded a contract for the carriage of goods by road. The driver deviated from the agreed itinerary, and the cargo on board struck a bridge, causing substantial damage to the cargo.

The cargo owners decided to sue the road haulier and its liability insurers on the basis of the Loi Badinter, in order to benefit from its strict regime for the compensation of victims of road traffic accidents. The aim was manifestly to circumvent the contractual limits of liability under the contract of carriage.

The Cour de Cassation held that the Loi Badinter is not intended to govern the compensation payable to owners of cargo damaged following a road traffic accident occurring during a voyage performed by a professional road haulier, pursuant to a contract of carriage.

Astonishingly, this was the first time since 1985 that this issue had been ruled upon by the Supreme Court, notwithstanding the considerable volume of litigation which the Loi Badinter has generated over almost four decades.

This issue is of significance for the insurance market, as it provides clarity on an issue which had not previously been tested. If the cargo owners had succeeded, this would have led to liability for the loss being potentially uninsured, since compulsory third party motor insurance policies usually exclude cargo carried on board the vehicle, while carriers' third party liability policies usually exclude cases of liability based on the Loi Badinter.

OLIVIER PURCELL
Partner, Paris
T +33 (0)1 44 94 31 90
E olivier.purcell@hfw.com

LOUIS CORNUT-GENTILLE
Senior Associate, Paris
T +33 (0)1 44 94 31 39
E louis.cornut-gentille@hfw.com

HFW has over 600 lawyers working in offices across the Americas, Europe, the Middle East and Asia Pacific. For further information about our Insurance/reinsurance capabilities, please visit www.hfw.com/Insurance-Reinsurance-Sectors

© 2022 Holman Fenwick Willan LLP. All rights reserved. Ref: 004039

Whilst every care has been taken to ensure the accuracy of this information at the time of publication, the information is intended as guidance only. It should not be considered as legal advice. Holman Fenwick Willan LLP is the Data Controller for any data that it holds about you. To correct your personal details or change your mailing preferences please email hfwenquiries@hfw.com