INSURANCE BULLETIN
NOVEMBER 2018 EDITION 1

In this week's Insurance Bulletin:

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1. REGULATION AND LEGISLATION

UK: Preparing for the worst: PRA update on Brexit and the Temporary Permissions Regime

The PRA has published a package of communications (including four consultation papers) which set out proposed changes to PRA rules and binding technical standards arising out of EU withdrawal. The communications are relevant to all firms authorised and regulated by the PRA, including passporting firms. The PRA has stated that the communications do not reflect any changes of policy and merely provide updates in light of the UK's withdrawal from the EU.

The proposed changes would not take effect until after the end of the "Implementation Period", which has been agreed in principle by the UK and EU as part of the Withdrawal Agreement. If the Withdrawal Agreement is not agreed, the Government has proposed to provide power to the PRA to grant transitional relief to ensure that firms have time to comply with any changes.

The PRA also provided further detail on the proposed Temporary Permissions Regime (TPR) which is intended to come into effect in the worse-case scenario: a hard Brexit with no Implementation Period. The TPR would allow firms currently passporting into the UK to continue carrying on regulated activities under a "deemed permission" for a maximum of three years while they seek authorisation from the UK regulators. The deemed permission would cover those activities the firm was permitted to carry on in the UK prior to exit day.

Set out below is a brief summary of the details published on the proposed TPR:

1. **Eligibility criteria for entry into the TPR and the notification process that firms will need to follow in order to enter the TPR**

   Only firms authorised to carry on regulated activities in the UK under the passporting regime on exit day will be eligible to enter the TPR. Firms will need to notify the relevant regulator of their intention to enter the TPR prior to exit day.

2. **Exit from the TPR**

   A firm's deemed permission under the TPR can end when (1) the application for authorisation is approved or rejected, (2) the PRA uses its own initiative power to cancel the deemed permission, or (3) three years from exit day (extendable by HM Treasury by 12 month increments). Where an application for authorisation is rejected, the firm will be expected to run-off its existing UK regulated activities.

3. **Extension of the PRA's statutory deadlines to process authorisation applications from EEA passporting firms (including any existing applications)**

   The current statutory time limits are 6-12 months; this would be extended to three years from exit day in order to allow the UK regulators time to manage the volume of authorisation applications (subject to parliamentary approval). This proposed extension is part of the legislation delivering the TPR and would therefore also be applicable during an Implementation Period.

4. **Regulatory requirements and Threshold Conditions for firms in the TPR**

   Firms in the TPR will be subject to the same obligations as if they were fully authorised; firms operating in the UK on a services basis only will be required to comply with a more limited set of rules based on the rules which currently apply to third country firms operating on a services basis. Firms will not be required to demonstrate that they satisfy the Threshold Conditions in order to enter the TPR however they will be required to notify the PRA if they believe they may have failed to satisfy the conditions.

5. **Possible transitional relief for firms in the TPR in respect of any rules or requirements that will apply to them for the first time**

   This includes rules in relation to Solvency and Minimum Capital Requirements for insurance

branches, certain reporting obligations, and certain composite rules for insurance branches.

6. **Financial Services Compensation Scheme (FSCS) protection**

   TPR insurers will be required to pay FSCS levies in respect of both new and existing policies that are protected by the FSCS and no transitional relief will be provided. The PRA is proposing to make changes to the FSCS rules for policies issued or re-issued after exit day such that they must relate to a risk or commitment situated in the UK, Channel Islands or Isle of Man in order to be protected.

7. **Senior Managers and Certification Regime and the TPR**

   Compliance with the requirements under the SM&CR will not be a pre-requisite of entry into the TPR. The PRA has also proposed that all firms in the TPR, including those only providing cross border services, will be required to have a person approved to perform the Head of Overseas Branch function.

Further information was also provided in respect of Solvency II approvals, Gibraltar firms and fees. The information published by the Bank of England on the TPR can be found at: https://www.bankofengland.co.uk/eu-withdrawal/temporary-permissions-regime.

The full package of communications can be found at: https://www.bankofengland.co.uk/news/2018/october/boes-approach-to-amending-financial-services-legislation-under-the-eu-withdrawal-act-2018.

Please do not hesitate to contact us if you would like advice on how Brexit may impact your business.

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UK: Managing the financial risks from climate change – PRA draft supervisory statement

Climate change has been a topic of discussion for a number of years, with consumers, vendors, financial services firms and investors keen to implement their personal and ethical views on their choice of financial products, culminating in "green bonds" and other "green" initiatives and products in the last few years.

It is widely agreed that climate change presents a tangible risk to the financial services industry, with the Bank of England publishing an article on its response to climate change in June 2017[1] following the Prudential Regulation Authority's (PRA) comprehensive paper on the impact of climate change on the UK insurance sector in September 2015[2].

With the above premise in mind the PRA published a consultation paper and draft supervisory statement on banks' and insurers' approaches to managing the financial risks from climate change. The purpose of the paper is to set out how effective governance, risk management, scenario analysis and disclosure may be applied by regulated firms to address the financial risks from climate change.

The PRA is seeking to have firms take a more strategic approach to managing the financial risks from climate change by taking into account the level of current risks, risks that can reasonably forseeably arise in future and identifying the actions required today to mitigate current and future risk. The PRA noted that the banking and insurance sectors have significant differences in the level of maturity of firms' responses to financial risk from climate change, as only a few firms have adopted a strategic approach to these risks.

The PRA notes that financial risks from climate change can arise through three different risk factors, physical, transition and liability. Physical risks arise from events such as specific weather events and longer term shifts in climate, and transition risks arise from the process of adjustment towards a low-carbon economy and developments in policy and regulation. Liability risks arise for parties who have suffered

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1 https://www.bankofengland.co.uk/quarterly-bulletin/2017/q2/the-banks-response-to-climate-change

2 https://www.bankofengland.co.uk/-/media/boe/files/prudential-regulation/publication/impact-of-climate-change-on-the-uk-insurance-sector.pdf?la=en&hash=EF9FE0FF9AEC940A2BA722324902FFBA49A5A29A

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loss or damage from physical or transition risks and are seeking to recover losses from those they hold responsible. The financial risks are distinctive and unique in that they can have significant implications, have uncertain or extended time horizons, are foreseeable in nature in that, while the exact outcome (and extent) is uncertain, there is a high probability that financial risks from some combination of physical and transition risks will occur. In addition, actions taken today by governments, firms and consumers will affect future impact.

The PRA is proposing that firms address these financial risks through their existing risk management framework in line with their general risk appetite and in a way in which it is proportionate to the nature, scale and complexity of their business. The PRA may seek evidence of how firms are monitoring and managing such risks in the form of the firms' risk appetite statements, as the PRA expects firms to understand the nature and scope of such risks on their business model. As such, the PRA expects firms to have clear roles and responsibilities for the board and its relevant sub-committees in managing these unique risks.

The full copy of the consultation paper and supervisory statement can be found at: https://www.bankofengland.co.uk/-/media/boe/files/prudential-regulation/consultation-paper/2018/cp2318.pdf.

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Australia: Notification of Circumstances following the Banking Royal Commission

Policyholders should ensure that there is no gap in their D&O cover by making broad and informed notifications of circumstances, in light of the Royal Commission's findings.

The findings in the Banking Royal Commission's interim report released on 28 September 2018, and hearings to date, identifies conduct by many financial services entities that may amount to a breach of the law.

Financial services entities are likely to look to their professional indemnity and D&O insurers for cover for any third party proceedings or regulatory investigations that follow.

In addition to the numerous AMP shareholder class actions that were commenced after round two of the hearings, a class action has been initiated against mortgage lenders and brokers, for mortgage miss-selling and irresponsible lending. While this was already on foot before the Royal Commission commenced, it is likely to draw heavily on its findings. More may follow. A more interventionist ASIC also seems inevitable, following the criticism of ASIC by Commissioner Hayne in the interim report, for infrequently pursuing financial institutions in Court, and following the recently announced funding boost.

So, how have insurers responded?

D&O insurers are already operating in a loss-making hard market that has driven significant increases to premiums in the last few years. An increase in claims following the Royal Commission will only exacerbate this trend.

Insurers have sought to contain their losses within current policy years via the introduction of Royal Commission exclusion clauses into newly incepted policies.

Careful attention should be given to the wording of these clauses.

A clause that seeks to exclude all claims that 'arise from' the Commission and/or its findings may have a narrow effect, depending on the circumstances of the claim. This is because the matters aired before the Commission are pre-existing circumstances, many of which were already the subject of breach reports to ASIC or current ASIC investigations. Further, the Commission is not a Court and does not make any findings of misconduct. It can only make findings that certain conduct might have amounted to misconduct and then refer it to the appropriate government agency to investigate and decide whether to bring proceedings.

On the other hand, exclusion clauses that are worded broadly to exclude,

for example, future claims arising out of, or connected with, the terms of reference of the Royal Commission, may have a much more far-reaching effect. The result may be that newly incepted policies containing such clauses may not respond to the types of exposures which are traditionally the very reason these policies are taken out.

So how should policyholders deal with these exclusion clauses, if they cannot be resisted?

Policyholders should ensure that there is no gap in existing coverage by making broad and informed notifications of circumstances under expiring policies. The current state of the law is that broad notifications of circumstances can be effective, although they should have regard to each individual policyholder's particular exposures based on the Commission's areas of focus. The wording of the notification should be informed by the breadth of the exclusion clause. It will also be important for policyholders and brokers to be able to explain to insurers why there is a potential for claim to be made, particularly in circumstances where the policyholder was not directly involved in the hearings but operates in the same industry.

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2. COURT CASES AND ARBITRATION

Australia: Liability for indivisible diseases is still indivisible

In the context of indivisible diseases such as mesothelioma, the NSW Court of Appeal has recently given important clarification that entities such as Amaca Pty Ltd (Amaca) (a former subsidiary of James Hardie) cannot limit their liability for injury resulting from asbestos exposure within Australia, by reference to separate exposure outside Australia.

In May this year the NSW Supreme Court confirmed that the Trustee for the Asbestos Injuries Compensation Fund is justified in limiting the damages to be paid to Francis Talifero's estate (Estate) despite the fact that Mr Talifero had an indivisible disease (mesothelioma). The Court of Appeal, however, disagrees and has advised that the Trustee is obliged to pay the Estate the whole of Amaca's liability under the award of damages.

Why is the Court of Appeal's decision important?

The effect of the first instance decision would have been to allow Amaca to occupy a unique position not shared by any other asbestos tortfeasors in Australia, and, in certain circumstances, to circumvent the orthodox position in Australia where liability for indivisible diseases is not subject to proportionality.

In practical terms, this would have:

- required other tortfeasors to assess the damages attributable to a claimant's Australian vs. non-Australian asbestos exposure when seeking contribution from Amaca.
- prevented the other tortfeasors from recovering contribution from Amaca for non-Australian exposure.
- potentially resulted in claimants with mesothelioma pursuing other tortfeasors to recover the shortfall resulting from Amaca's underpayment.

Background

Mr Talifero was exposed to asbestos in Australia and the United Kingdom. His claim against Amaca, however, was framed by reference to his Australian-based exposure only. The NSW Dust Diseases Tribunal found that Mr Talifero's Australian-based exposure was sufficient to cause his mesothelioma and his Estate was awarded $560,482.00 in damages, plus costs.

An exercise in interpretation

At its core, this matter involved an exercise in interpretation of the key terms of three instruments: the James Hardie Former Subsidiaries (Winding up and Administration) Act 2005 (Act), the Asbestos Injuries Compensation Fund Trust Deed and the Final Funding Agreement (Funding Agreement). By way of

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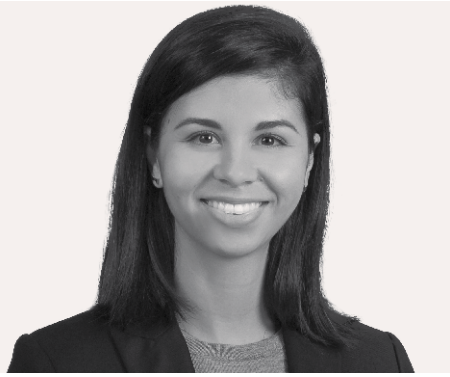

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background, these three instruments comprise the tripartite scheme under which payable liabilities of James Hardie's former subsidiaries are met.

Supreme Court decision

Despite differences between their key terms, first instance judge, Justice Sackar, held that the three instruments should be read together in harmony. His Honour's interpretation of these terms, combined with the history of the tripartite scheme and the finite resources available to fund potential liabilities, led him to find that the Trustee is obliged to limit the damages payable to the Estate to the proportion of damages relating to Mr Talifero's Australian-based asbestos exposure.

Court of Appeal decision

Justice Sackar was overruled by all three judges of the Court of Appeal.

Having established that the Estate's award of damages flowed from a claim founded exclusively on exposure to asbestos in Australia, Sackville AJA (Beazley P agreeing) was satisfied that the Act allows for the entirety of the award to be paid by the Trustee, despite Mr Talifero's exposure in the United Kingdom. Furthermore, given the role of the Act in providing a framework for the operation of the Funding Agreement, to construe the Funding Agreement as prohibiting a payment authorised by the Act is not, according to Sackville AJA, a harmonious reading.

Acting Justice of Appeal Emmett took a different approach in his interpretation: if Mr Talifero inhaled the fibre that caused his mesothelioma in Australia, he (or rather his Estate) is entitled to the full amount of the award. On the other hand, if the fibre causing Mr Talifero's mesothelioma was inhaled outside Australia, there would be no entitlement to any part of the award. Such an inquiry, however, was not before the Court of Appeal.

We have no doubt that the clarification provided by the Court of Appeal comes as something of a relief to other asbestos product suppliers in Australia.

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3. MARKET DEVELOPMENTS

UK: Lloyd's Market Association (LMA) Brexit clauses published

The LMA has published a number of model Brexit clauses which address the following:

1. **Lloyd's Brussels:** Lloyd's has established a new insurance company in Brussels ("Lloyd's Brussels") which will underwrite non-life insurance and facultative reinsurance risks located in EEA countries with effect from 1 January 2019. The LMA has published model clauses on "Shared Limits" and on "Shared Aggregate Deductibles" to address the consequences of the creation of Lloyd's Brussels.

2. **Brexit affected policies:** the LMA has published model clauses to be endorsed onto policies affected by Brexit due to the policies referring to EU law and regulation and/or to the EU in terms of the territorial scope of the policy. The LMA also published a clause to clarify that automatic coverages provided by the policy for entities acquired or established by an insured should not apply to the extent that, post Brexit, the insurer is not permitted by applicable law or regulation to provide such coverage.

3. **Syndicates outward reinsurance treaty exclusions:** the new model clause provides clarification of the treatment of the reinsurance of Lloyd's Brussels business which is ceded by the syndicate.

The LMA Bulletin and the model clauses can be found at: https://www.lmalloyds.com/LMA/News/LMA_bulletins/LMA_Bulletin_2013/LMA18_044_AC.aspx.

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UK: More questions than answers: Lloyd's will pay all valid claims following a hard Brexit

Lloyd's has recently confirmed in a press release (https://www.lloyds.com/news-and-risk-insight/press-releases/2018/10/hard-brexit-lloyds-commits-to-pay-all-valid-claims) that it would pay all valid claims if the proposed transitional period, or a similar arrangement, is not agreed between the UK and the EU, such that there is a "hard Brexit". However, the press release poses more questions than it answers.

The press release refers, almost in passing, to a Part VII transfer which Lloyd's is undertaking in order to transfer all EEA business to Lloyd's Brussels. The target date for completion of this Part VII transfer is the end of 2020, and Lloyd's has billed its announcement that it will pay all valid claims in event of a hard Brexit as a stop-gap for the period between Brexit and completion of the Part VII transfer.

There are two potential issues with this:

1. If there is a hard Brexit, it may not be possible to complete Lloyd's Part VII, as the legal mechanism for completing a cross-border Part VII may simply fall away. This may be an issue even if a transitional period is agreed, and the terms of the withdrawal agreement would need to be checked carefully.
2. Lloyd's will lose its passporting rights following Brexit. If a transitional period is not agreed (or if an equivalent to passporting rights is not agreed as part of the withdrawal agreement), a Lloyd's managing agent which pays a claim to, for example, a German policyholder could be doing so in breach of German law. Lloyd's has clearly anticipated this, as its press release states that it "expects that [Lloyd's commitment to pay claims] will have the support of all European regulators as it goes to the heart of treating customers fairly." This seems a little optimistic in light of recent papers published by EIOPA, which have taken a hard line on the payment of claims by UK (re)insurers to EEA policyholders.

A final, unspoken, line of Lloyd's press release lies in its timing: published shortly before the UK and the EU are due to agree a deal or declare a hard Brexit, the issues which a hard Brexit will present, as highlighted by the press release, will hopefully encourage the UK and the EU to do the former.

However, Lloyd's has sensibly continued to prepare for a hard Brexit. Part of these preparations included confirming recently that Lloyd's Brussels subsidiary will be ready to write facultative reinsurance and non-proportional treaty reinsurance from 1 January 2019. Lloyd's is expecting that the UK will secure Solvency II reinsurance equivalence in 2019, enabling Lloyd's to write the remaining treaty reinsurance business, but has said that in any event it will be ready to process the remaining treaty reinsurance business through Lloyd's Brussels subsidiary from 1 January 2020.

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4. HFW PUBLICATIONS AND EVENTS

HFW Briefing: Iran sanctions: The English Court steers a course

HFW's Daniel Martin and Michael Ritter assess the practical impact of the Commercial Court ruling in *Mamancochet Mining Limited v Aegis Managing Agency Limited and others*[1] that provides much needed guidance on how the UK courts will deal with the US withdrawal from the JCPOA. Read the full briefing here: http://www.hfw.com/Iran-sanctions-The-English-Court-steers-a-course

1 [2018] EWHC 2643 (Comm)

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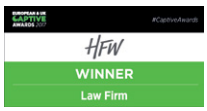

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