



Welcome to HFW's Insurance Bulletin, which is a summary of the key insurance and reinsurance regulatory announcements, market developments, court cases and legislative changes of the week.

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hfw 1. Regulation and legislation

UK: Game of drones: challenges for insurers

Drones are making the news. To take one example, the use of drone technology in the fight against Islamic State in Iraq and Syria has been a constant source of recent controversy. But the increasing prominence of unmanned aerial vehicles (UAVs) has extended far into the civilian sphere too.

Google announced this week that it plans to use drones to deliver packages to customers by 2017. Indeed, in London, drone delivery services already exist and in Japan, over 2,400 drones spray almost half of the country's rice crop. As drone technology continues to evolve, insurance will inevitably be required to protect against these emerging risks. In developing the necessary insurance products to meet this growing demand, insurers will need to deal with a vast array of legal, regulatory and commercial uncertainties.

Various different types of insurances are needed. Most standard forms of drone insurance cover third party liability, physical loss and damage to the components during transport or operation. Since drones have numerous different applications, policies may need to be tailored to include D&O liability; professional indemnity; employers' liability; product liability; cargo liability; terrorism; war and hijacking. Intellectual property cover is also needed, as manufacturers seek to protect their innovations from theft by competitors. Drone insurance is often viewed under the general umbrella of aviation products, but there are key differences between drone and general aviation risks. Drones, for example, can be used for surveillance

and data-gathering, and the risk of a privacy or cyber breach could present potentially ruinous aggregation issues for insurers.

Insurers face numerous difficulties in assessing the profitability and risk of providing drone insurance. Statistical data about safety are very limited. Drones are vulnerable targets for cyber attacks, as they mostly use unencrypted data links for their command and navigation. Moreover, insurers cannot easily assess the competence of the operators they insure. Therefore the development of a central database and standardised CAA licensing for drone operators are likely to be important features in the future.

In addition to these commercial issues, drone insurance presents various legal and regulatory headaches. Regulation of drone insurance is in its infancy. EU Regulation 785/2004 has established a minimum third party insurance requirement of €660,000 for commercial drones that weigh between 20 and 500kg but, in a report published in March 2015 (*the EU Committee Report*), the EU Committee of the House of Lords recommended that this minimum be increased. The EU Committee Report also recommended that national aviation authorities in EU member states should share incident statistics in order to improve the information required to determine premiums.

As to regulation of drones themselves, the current approach of correlating level of regulation to weight is problematic: the weight of a drone may have little correlation with the scale of losses that could be incurred were it, for instance, to suffer a large data security breach. Regulation is patchy between international jurisdictions and there are no harmonised international standards on third party liability requirements. The pressure for compulsory registration of

commercial and civilian drones is likely to intensify. The EU Committee report recommended that all commercial drones should be registered online but the government's response was cautious, recommending careful consultation and suggesting that over-regulation should be avoided in order to prevent a *"a situation where the full weight of regulation is applied to the lighter end of the industry, killing it off or stifling growth before it has a chance to be properly established."* The EU Committee will debate the government response during this current parliament.

At the EU level, progress is currently being made. In July, the European Aviation Safety Agency (EASA) published a consultation paper (*A-NPA 2015-10¹*) as a first step in the creation of common European safety rules for operating drones regardless of their weight. The consultation closed on 25 September and EASA is currently preparing a technical opinion for submission to the European Commission by the end of this month. In the USA, similar regulations for unmanned aircraft are expected to be finalised in 2017.

Thomas Jefferson once said *"with great risk comes great reward"*. With expenditure on drone acquisition expected to reach \$91 billion by 2024, drone insurance premiums could indeed be very lucrative for insurers. But until there is greater harmonisation of laws and better regulation, licensing and statistical data, it will remain challenging for insurers to know what price to put on that risk.

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¹ <https://www.easa.europa.eu/system/files/dfu/A-NPA%202015-10.pdf>

UK: The countdown to the implementation of Solvency II – Bank of England update

On 3 November 2015, the Bank of England's Executive Director of Insurance Supervision, Sam Woods, gave a speech to the Association of British Insurers on the countdown to Solvency II and the current status of implementation.

Mr Woods stated that the PRA is currently reviewing approximately 300 Solvency II applications, including around 20 applications from firms seeking approval to use an internal model with effect from 1 January 2016. He explained that each internal model application will be considered by a panel made up of PRA senior management, following which it will be reviewed by a separate senior decision-making panel which will have the final say on whether to approve the application. He added a note of caution for firms that receive internal model approval, reminding them that they should *"make sure their models remain fit for purpose on an ongoing basis and...assure [the PRA] that this is the case."*

In terms of the PRA's timetable for determining applications, Mr Woods expected each firm to receive the decision on its application in early December. Mr Woods expected this to be preceded by the PRA's decisions on matching adjustment applications, which he envisaged would be issued early this month.

Mr Woods went on to discuss the:

- Introduction of the risk margin and its role in the new regime. He extolled the benefits of the risk margin and set out his belief that it should help to provide extra protection for policyholders.



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WILLIAM REDDIE, ASSOCIATE

- Use of transitional measures by firms. He reminded the audience of his statement from earlier in the year which confirmed that the PRA will allow a firm to use transitional measures if it qualifies to use them.
- Implementation of the volatility adjustment. Mr Woods noted that differences of opinion exist across Europe regarding the use of the volatility adjustment and that these different views will need to be "ironed out" in order to create a level playing field across Europe.

Mr Woods concluded by discussing the level of capital that firms must hold in order to satisfy regulators. He addressed concerns in the market that the PRA would expect firms to hold capital far in excess of the Solvency Capital Requirement (SCR) by explaining that firms were free to hold capital in excess of the SCR, but dismissing the idea that the PRA had in mind a specific figure.

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hfw 2. Market developments

UK: BIBA and ABI to develop a joint code for managing the insurance renewals of potentially vulnerable customers

The British Insurance Brokers' Association (BIBA) and the Association of British Insurers (ABI) have announced that they are working on a code for managing the insurance renewals of potentially vulnerable customers. The code will be voluntary for BIBA and ABI members and, according to the ABI, will aim *"to bolster greater trust between insurers and customers"*.

The code will apply to motor and home insurance customers, and will put in place measures to support individuals whose personal circumstances mean that they may not be able to consider the alternatives which are available to them at renewal, and may simply renew their policy each year without checking or understanding other options which may be available.

The code will aim to ensure that these individuals continue to have cover in place which is appropriate and which meets their needs. Insurers and brokers that comply with the code will undertake to train staff, improve business processes and tailor their customer communications, in order to help them deal appropriately with vulnerability at renewal.

The ABI and BIBA have indicated that they aim to publish the code by the end of the year.

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hfw 3. HFW publications and events

EU: Taxing times: the European Commission gets tough on preferential tax rulings

HFW has published a briefing (<http://www.hfw.com/The-European-Commission-gets-tough-on-preferential-tax-rulings-October-2015>) on the European Commission's decision that Starbucks and Fiat should pay back "illegal" State aid. As a result of the decision, Starbucks and Fiat will be required to pay back between €20 and €30 million each, the total benefit they are said to have received under tax rulings granted by the tax authorities of the Netherlands and Luxembourg.

The briefing explains what constitutes State aid and why the Starbucks and Fiat deals were illegal, examines the consequences for a company's tax structures, and provides some practical guidance for companies that have received past rulings from tax authorities and/or have dealings with public entities.

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Great Britain/Nigeria: HFW attends Opportunity Nigeria seminar and Made in Nigeria showcase

On 5 and 6 November, Partner **Graham Denny** attended the Opportunity Nigeria seminar and Made in Nigeria showcase in London, which were organised by the Nigerian-British Chamber of Commerce. The events were an opportunity to meet with various trade delegates and partners who do business in Nigeria. The event was a testament to the nation's development and importance to various industry sectors which, like many African nations, require support from the insurance and reinsurance sector to further their attractiveness to foreign investors and fuel their indigenous industrial growth.

UK/China: HFW present at Willis seminar on the impact of the Tianjin Port explosions on the global insurance market and policyholders

On Monday 9 November 2015, HFW presented at a Willis seminar which looked at the impact of the Tianjin Port explosions on the global insurance market and policyholders.

HFW Partner **Craig Neame** delivered a unique insight into the port and its role in global supply chains, the main protagonists in the incident, the regulatory environment, the cargo losses in their sale contract contexts, and the affected primary policies. HFW

Partner **Paul Wordley** gave a detailed overview of the coverage, reinsurance and subrogation issues which insurers should be aware of, as well as insight into the political considerations.

The seminar also included a presentation by Lincoln Pan, CEO of Willis China, who shared some of the practical challenges facing the claims recovery process, including chemical contamination on site and sheer challenge of processing and moving inventory around the damaged port area. Mervyn Chen of Wintell & Co joined the speakers for the panel discussion and provided a Chinese legal view of the aftermath of the event. The conference was attended by over 250 delegates.

Bermuda: HFW attending ILS Bermuda Convergence 2015

From 11 to 13 November, **Richard Spiller** and **Andrew Bandurka** will be attending the ILS Bermuda Convergence 2015.

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