Insurance/
Reinsurance

18 June 2015





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.

In this week's Bulletin:

Should you require any further information or assistance on any of the issues dealt with here, please do not hesitate to contact any of the contributors to this Bulletin, or your usual contact at HFW.

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1. Regulation and legislation

EU: UK Government update on European negotiations over the Cyber-Security Directive

The UK Government Department for Business, Innovation and Skills (BIS) produced a note dated 5 June 2015 (later released by the Bank of England), that confirms negotiations started in August 2014 between the European Council and European Parliament on the proposed directive to ensure a high common level of network and information security across the European Union (also known as the Cyber-Security Directive).

Some areas have been informally agreed. These include flexibility for Member States to use existing structures for the institutional structure required e.g. setting up emergency response teams and allowing Member States to develop guidelines on what a reportable incident is, and that cooperation between Member States and information sharing should be voluntary. Concerns which led to these agreements appear to include cutting down on the associated costs, and avoiding over-regulation.

Areas of disagreement remain regarding the scope and cooperation of incidents. The European Council would prefer Member States to decide which companies are in scope to allow them to focus on only critical services, whereas European Parliament wants all companies to be included (and the BIS considers this could represent an unjustifiable regulatory burden). Furthermore, there is no agreement on whether digital services e.g. search engines and social media websites should be in scope (which the European Council is divided on – the UK having previously felt a lack of any significant disruptive effect does not merit regulation) or excluded (which European Parliament wants), but negotiations have not yet touched on this.

It is estimated this will be resolved before summer 2015, but may not be agreed until autumn this year. On agreement, Member States will then have two and a half years to implement the directive into national law.

A copy of the note can be found here: http://www.bankofengland.co.uk/financialstability/fsc/Documents/nisupdatejune2015.pdf

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THOMAS COOMBS, ASSOCIATE

EU: Solvency II equivalence decisions – Switzerland, USA and Bermuda among those to make the cut

On 5 June 2015, the European Commission adopted its first third country equivalence decisions under Solvency II, granting Switzerland, Australia, Bermuda, Brazil, Canada, Mexico and the USA full or partial equivalence.

The decisions are delegated acts and are subject to scrutiny by the European Parliament and Council before they can take effect, which is expected to be within three months.

What is equivalence?

Solvency II permits the European Commission to determine that a third country's insurance regulatory regime is equivalent to Solvency II in three areas:

1. Reinsurance (article 172): if a third country's rules are deemed equivalent under this article, Solvency II firms and regulators must treat reinsurance contracts with reinsurers established in that country in the same way as reinsurance contracts with EU reinsurers.

2. Group Solvency Calculation (article 227): this is relevant where a group which is supervised in the European Economic Area (**EEA**) has sister companies or subsidiaries in a third country. If the third country's rules are deemed equivalent under this article and the EEA group uses the deduction and aggregation method of consolidation for group solvency purposes, the EEA group can use the third country's rules (rather than the Solvency II rules) in order to calculate the capital requirements and own funds of the third country company for group solvency purposes. Where the third country's rules have not been

deemed equivalent, the company in the third country would need to recalculate, using the Solvency II rules, its capital requirements and own funds for use in the EEA group's calculations.

3. Group Supervision (article 260): this is relevant where a UK (or EEA) firm has a parent in a third country. Where the third country's rules are deemed equivalent under this article, the EEA supervisor of the Solvency II firm must rely on the group supervision regime of the third country, which will be the Group Supervisor.

Following advice received from the European Insurance and Occupational Pensions Authority (**EIOPA**), the European Commission has determined that Switzerland's regime is fully equivalent to Solvency II. It has decided that Switzerland is to be given full equivalence in all three of the above areas, such equivalence to be granted indefinitely from 1 January 2016.

Six other countries – Australia, Bermuda, Brazil, Canada, Mexico and the USA – have been determined to be provisionally equivalent in respect of solvency calculations under article 227. Provisional equivalence is granted where the country may not satisfy all of the criteria for full equivalence, but progress is being made towards equivalence and it is expected that an equivalent regime will be adopted. The EIOPA reports highlight the areas where such regimes are not yet fully equivalent. This decision on article 227 equivalence allows the relevant countries to be treated as equivalent for the purposes of article 227, but only for 10 years from 1 January 2016. At the end of this period, the European Commission will need to reassess the developments in each country's regime and determine whether to grant full equivalence or a further period of temporary equivalence in respect of each.

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RUTH HITE, SENIOR ASSOCIATE

Implications of equivalence for firms with connections to Switzerland, Australia, Bermuda, Brazil, Canada, Mexico or the USA

For UK firms which have Swiss holding companies or sister companies or reinsurance contracts with Swiss authorised counterparties:

1. Reinsurance with Swiss-regulated counterparties is to be treated in the same way as reinsurance with EU counterparties.

2. There is no requirement to convert the Swiss capital requirements and capital resource calculations into Solvency II calculations.

3. If the group supervisor is the Swiss regulator (**FINMA**) then the Prudential Regulation Authority (**PRA**) must rely on the group supervision by FINMA rather than conducting group supervision itself.

In summary, this full equivalence decision means that navigating the interaction of Swiss and EU regulatory regimes is likely to be significantly easier than in other third country jurisdictions.

For a UK firm which has a sister firm regulated in any of the six provisionally equivalent jurisdictions (Australia, Bermuda, Brazil, Canada, Mexico or the USA), the decision extends only to the calculation of group capital requirements and capital resources (note that captives regulated in Bermuda are excluded from the equivalency decision). The European Commission's decision is helpful as it removes the requirement to run capital resource and capital requirement calculations in accordance with two separate regulatory regimes (one for Solvency II requirements and one for the relevant third country requirement) which would otherwise apply. We expect this to be of wide-ranging benefit to industry as the solvency calculation equivalence is, of the three types of equivalence, perhaps of most importance to international insurance groups – cutting down on reporting requirements and potentially reducing the level of group capital required (as the capital requirements calculated on a Solvency II basis are likely to be higher than those calculated on a local basis).

However, the six provisionally equivalent jurisdictions have not yet been deemed equivalent in relation to reinsurance. This means that any reinsurance with a provisionally equivalent counterparty (or any other third country regulated counterparty) may attract additional collateral requirements or otherwise not operate effectively to reduce the UK firm's capital requirements in the way it would for reinsurance with an EU counterparty. The position in relation to reinsurance is currently under negotiation between the EU and the USA, where industry and regulators consider this issue to be particularly significant.

The six provisionally equivalent jurisdictions have also not yet been deemed equivalent in relation to group supervision. This means that any UK firm within a group supervised by one of the provisionally equivalent jurisdictions (or any other third country group supervisor) may still be subject to dual group-wide supervision, at least in theory. However, in the absence of a European Commission decision, unlike reinsurance equivalency, article 260 allows the acting group supervisor (assisted by EIOPA and in consultation with the other supervisory authorities concerned) to assess third country equivalence for the purposes of group supervision. Therefore, the PRA may determine that the relevant third country is equivalent for the purposes of group supervision. It is not yet clear how the PRA intends to approach this determination but this is likely to depend on the current relationship with the third country regulator and the potential risks posed to the UK in reliance on the third country group supervision.

There is a further pragmatic solution available to the PRA where neither the European Commission or the PRA have determined a third country to be equivalent for the purposes of group supervision. The Solvency II directive explicitly envisages that the PRA may apply "other methods" to group supervision instead of supervising the worldwide group as well (which would effectively be overlaying the third country group-wide supervision with a second layer of Solvency II compliance oversight by the PRA). As set out in PRA Supervisory Statement SS12/15, the PRA expects to apply these "other methods" to firms on a case by case basis and firms should apply for such "other methods" by way of a waiver application form in the usual manner.

This is potentially particularly helpful in the case of jurisdictions such as the USA where the regulatory regime and group-wide supervision is far more developed in certain states compared to others. Firms which are currently part of a group subject to third country group supervision may feel that it is worth submitting a waiver application to the PRA in advance of Solvency II coming into force, in order to start the dialogue with the regulator about what "other methods" the PRA will apply to the group in the absence of jurisdiction-wide equivalence being granted.

What's next?

Decisions on other jurisdictions and on other types of equivalency will follow. In particular, Japan, which was the subject of an EIOPA report on reinsurance equivalence in March, is expected to be granted full or provisional equivalence and we watch the USA-EU negotiations on reinsurance equivalency with interest.

Copies of the European Commission's decisions can be found here: http://ec.europa.eu/finance/insurance/docs/solvency/international/delegated-act-c-2015-3754_en.pdf and here: http://ec.europa.eu/finance/insurance/docs/solvency/international/delegated-act-c-2015-3740_en.pdf.

The EIOPA reports on Bermuda, Japan and Switzerland are available here: https://eiopa.europa.eu/Pages/News/EIOPA-publishes-the-Final-Reports-on-full-equivalence-assessments-of-Bermuda-Japan-and-Switzerland.aspx.

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WILL REDDIE, ASSOCIATE

2. Market developments

UK: AIRMIC releases Insurance Act endorsement

The Association of Insurance and Risk Managers in Industry and Commerce (AIRMIC), has published a technical briefing paper which is designed to help commercial policyholders benefit from the changes introduced by the Insurance Act 2015 before it comes into force in the autumn of 2016 (in relation to contracts made after that date).

The Insurance Act was passed in February of this year. It represents fundamental reform of the laws governing commercial insurance and includes critical safeguards for policyholders. As well as providing extra protection for commercial policyholders, the act will bring the UK up-to-date and into line with other insurance markets. As a result, AIRMIC has been encouraging its members to start preparing for the changes as soon as possible, and to start talking to their brokers and insurers. Unless current policy wordings are changed, policyholders will not see the benefits introduced by the new act until 2016.

AIRMIC's briefing paper provides a series of sample wordings and endorsements which policyholders can use to amend the terms of an existing policy so as to bring it into line with some of the key reforms introduced by the act. The elements of the act covered by the endorsements include the provisions relating to basis of contract clauses, breach of warranty, breach of terms unrelated to the actual loss and remedies for non-disclosure. The draft endorsements do not cover the provisions in the act which deal with the duty of fair presentation of risk or fraudulent claims. AIRMIC's chief executive has urged members to read

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CIARA JACKSON, ASSOCIATE

the briefing paper and use it as the basis of discussions with its insurers. The wordings should be incorporated into existing policies carefully, and insureds should of course exercise particular caution of their existing policies are more advantageous than the terms of the act.

A copy of the technical briefing paper which contains the sample wordings and endorsements can be found here: http://www.airmic.com/system/files/private/Insurance%20Act%202015_WEB.pdf

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UK: Risk Management Society (RIMS) predicts widespread purchase of cyber cover

RIMS, based in New York, has conducted its first survey of risk managers in respect of cyber risk. The survey includes input from 284 risk professionals, of which 58% are companies with more than US$1 billion in annual revenues.

The survey indicates that, of the companies which currently do not have cyber coverage in place, 74% are considering purchasing cyber cover in the next 12 to 24 months.

The survey also reveals that 58% of the organisations which do purchase cyber cover have less than US$20 million of cover in place. Of this number, 49% of the organisations are paying more than US$100,000 in premium. The survey found that 51% of the organisations surveyed purchase stand-alone policies.

The results of the survey can be found on the RIMS website: https://www.rims.org/.

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3. HFW publications and events

UK: Insurance Act 2015

HFW has published a consolidated version of its briefings on the UK Insurance Act 2015. The consolidated version takes into account some of the recent guidance which has been issued on the act. A copy of the briefing can be found here: http://www.hfw.com/The-UK-Insurance-Act-2015-June-2015

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HFW paper on trade sanctions in insurance and reinsurance – Polish Insurance Association seminar

HFW Partners Andrew Bandurka and Daniel Martin attended the Polish Insurance Association's "Legal and Political Risks in Reinsurance" seminar in Warsaw on 16 June 2015, at which Daniel Martin presented a paper titled "Trade Sanctions in Insurance and Reinsurance".

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