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INSURANCE BULLETIN

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In this week's Insurance Bulletin:

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1. REGULATION AND LEGISLATION

UK and Europe: Insurance Distribution Directive – delayed until October 2018?

The European Parliament's Economic and Monetary Affairs Committee has recommended that the application date for the Insurance Distribution Directive (IDD) be delayed until 1 October 2018. If this recommendation is adopted by the European Commission, each EU member state would still be required to transpose the IDD into its national legislation by 23 February 2018, but insurance intermediaries would not be required to comply with the new legislation until 1 October 2018.

The ECON's recommendation has been made to enable the insurance industry to have sufficient time to implement the technical and organisational changes which would be necessary to comply with the new legislation and regulatory requirements, some of which have yet to be finalised, both at a European level and at member state level. At the time of publication, Commission Delegated Regulations which were adopted in September had not formally entered into force and, as reported in our bulletin of 16 October[1], the FCA's most recent consultation paper on the IDD was published only in September and remains open until the end of November, with the final policy statement not expected until January 2018.

It is therefore not surprising that ECON's recommendation has been welcomed by the industry, with the ABI's director of regulation commenting that *"it is important to grant insurers the sufficient time to properly implement the complex requirements"*. The director general of Insurance Europe agreed, stating that *"Insurers need to be given sufficient time to implement the IDD and they can only do so with legal certainty, once the final rules are known."*

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Hong Kong: Insurance Authority promotes Fintech/ Insurtech and Online Insurance

Since taking over as Hong Kong's new insurance regulator in June of this year, the Insurance Authority (IA), has been tasked with modernising the regulatory framework as well as facilitating the development of the industry. In line with these objectives, in September 2017, the IA launched an Insurtech Sandbox, introduced a new fast track application procedure for online-only insurers seeking authorisation to conduct business in Hong Kong and entered into a cooperation agreement with the UK's insurance regulator, the Financial Conduct Authority (FCA), to collaborate in supporting Fintech innovation.

"Insurtech Sandbox"

On 29 September 2017, the IA launched the Insurtech Sandbox, a pilot scheme to permit existing Hong Kong authorised insurers to work with technology firms in trying out new insurtech applications for their business operations.

The Sandbox is subject to the following principles:

- The insurers must provide a viable framework for the trial of the application, by:
  - Setting out the duration of the trial.
  - Providing details of the size and type of insurance business involved.
  - Identifying the target users.
  - Identifying the insurtech and new technological initiatives involved.
  - Identifying the success criteria of the trial.

1 http://www.hfw.com/Insurance-Bulletin-October-2017-Edition-3

An insurer which is trialing the application must also:

- Put in place adequate risk management controls.
- Ensure that adequate customer protection exists in relation to the trial, including by making it clear to customers that they are part of a trial.
- Maintain adequate resources.
- Present an appropriate exit strategy for the trial.

"Fast Track"

On 29 September 2017, the IA set up an expedited application process for insurers seeking authorisation to carry on insurance business in or from Hong Kong solely by way of digital distribution channels. This pilot scheme is known as "Fast Track".

The scheme is aimed at the on-line sale of non-complex insurance products (such as travel and personal accident insurance) directly to consumers through digital distribution channels owned or operated by the insurers.

The following principles apply for the Fast Track. The insurer must:

- Own or operate the relevant digital distribution channel.
- Not use traditional agency channels (insurance agents, brokers or banks).
- Meet solvency/capital requirements.
- Demonstrate that there are protective measures in place for policyholders.
- Comply with stated shareholder requirements with regard to long term business, i.e. one of the shareholder controllers should be an insurer (or the subsidiary/affiliate of an insurer) authorised to carry on the relevant insurance business in Hong Kong or a jurisdiction which has an information exchange arrangement with the IA (such as the UK).

Fintech Co-operation Agreement between the FCA and the IA

On 12 September 2017, the FCA in the UK and the IA signed a Co-operation Agreement with a view to providing a framework for the exchange and referral of information on innovative fintech products and services.

The main objective is for both authorities to stay abreast of fintech innovation and to share information on a confidential basis with the possibility of joint projects being undertaken. Both will exchange and refer information in relation to emerging trends and developments and regulatory issues arising from fintech, and will provide each other with details of organisations which lead efforts to promote fintech innovation.

A copy of the Co-operation Agreement can be found at https://www.fca.org.uk/publication/mou/fca-ia-co-operation-agreement.pdf

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2. COURT CASES AND ARBITRATION

England & Wales: Court upholds application of insolvency exclusion

The professional indemnity insurer of an insolvent independent financial adviser (Target) successfully relied on an insolvency exclusion in the policy to deny liability to third party (former) clients of Target[1].

In 2005 Target had advised Mr. and Mrs. Crowden to invest £200,000 in a "Secure Income Bond" issued by SLS Capital SA in Luxembourg and Keydata Investment Ltd.[2] SLS went into liquidation in 2009.

The Crowdens lost £150,000, and later received only £84,642.92 in

1 *Crowden v QBE [2017] EWHC 2597 (Comm)*

2 The collapse of Keydata cost the FSCS hundreds of millions of pounds in compensation to investors who lost their life savings. The FSCS fined Keydata directors/officers nearly £80m in May this year, citing "lack of integrity" and "reckless" actions, and saying the regulator had been "deliberately misled" by them. Challenges to the fines are, we understand, currently being pursued.

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CONSULTANT

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ANDREW BANDURKA
PARTNER

"The insolvency exclusion was not limited to non-negligent acts or omissions, on the basis that there was no suggestion in the language of the provision that it was so limited, and it would be odd if there were cover for negligent conduct, which the insured could control, but not for non-negligent conduct. "

FSCS compensation, due to the FSCS cap. Target entered liquidation but, undaunted, the Crowdens sued Target, and were able to obtain judgment for £197,698.05 after the liquidator chose not to defend the proceedings. Target's PI insurer had declined to participate in the proceedings, on the grounds that it considered it had no obligation to indemnify Target due to the insolvency exclusion, which excluded "claims…arising out of or relating directly or indirectly to the insolvency…of the Insured or of any… business…with whom the Insured has arranged…any…investments". The Crowdens sued the insurer pursuant to the Third Parties (Rights Against Insurers) Act 1930 (which applied since the insolvency preceded the more recent Act's effect.)

There was an issue whether, notwithstanding their judgment against Target, the Crowdens' entitlement to claim against Target had survived their acceptance of FSCS compensation, since the FSCS rules require claimants to assign to it their rights against responsible parties, and any such assignment appeared to have taken place before they issued proceedings against Target. This issue was not suitable for determination on the insurer's summary judgment application, but the Judge was able to follow established precedent[3] in ruling that the fact of the Crowdens' judgment against Target did not preclude the insurer from contesting that Target had been liable to the Crowdens by reason of the Crowdens' purported assignment.

However, in upholding the effectiveness of the insolvency exclusion in the insurer's favour, the Judge reviewed the tenets for construing insurance exclusions[4] and commented that the ordinary principles of construction generally applicable to exemption clauses were not to be adopted in the interpretation of insurance exclusions, because insurance exclusions are intended to define the scope of cover under the policy, rather than being contractual exclusions *per se*.

3 *Astrazeneca Insurance Co Ltd –v- XL Insurance (Bermuda) Ltd [2013] EWCA Civ 1660; [2014] Lloyd's Rep IR 509*

4 *Impact Funding Solutions Ltd. v Barrington Support Services Ltd [2016] UKSC 57 [2017] AC 73*

The Judge further held the clause was not ambiguous, and rejected the Crowdens' arguments that the insolvency exclusion only applied if: (a) there had been a non-negligent act or omission giving rise to Target's liability and/or (b) Target had arranged an investment with the insolvent business on its own behalf and not on its client's behalf and/or (c) the relevant insolvency was a formal insolvency process, rather than an inability to pay debts as they fell due. The Judge found little support for these arguments and ruled that, for this particular clause to bite, the relevant insolvency need not be the proximate cause of the loss, since other language (e.g. "caused by") would have been used if this had been the intention, but that the insolvency must have been a significant cause, as it was here. The insolvency exclusion was not limited to non-negligent acts or omissions, on the basis that there was no suggestion in the language of the provision that it was so limited, and it would be odd if there were cover for negligent conduct, which the insured could control, but not for non-negligent conduct.

The unfortunate Crowdens therefore had no real prospect of success in their claim against the insurer, and this was also the case in respect of an additional £150,000 which they had invested through Target in Lehman Bros. Inc. securities.

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3. MARKET DEVELOPMENTS

UK: AIG writes first Sharia-compliant W&I policy as UK targets Islamic insurance

AIG announced on 19 October that it has written its first Sharia-compliant warranty and indemnity (W&I) policy out of London's M&A market. AIG developed the policy in conjunction with Cobalt Underwriting, a Sharia-compliant managing general agent, which HFW were involved in establishing (as reported here: http://www.hfw.com/HFW-advises-Capita-on-Cobalt-investment-May-2013).

Islamic finance is one area which the UK is seeking to develop ahead of Brexit, and AIG's first W&I policy follows recent moves by the UK and the insurance market as a whole to target Islamic financial services. Back in 2013, the then-Prime Minister David Cameron confirmed at the World Islamic Economic Forum that the UK would seek to establish London as a global Islamic finance centre, and a recent report found that Britain is now the leading Western centre for Islamic finance.

Although (re)insurance was the last financial services sector to offer Sharia-compliant products, it seems that the industry is making attempts to catch up. Lloyd's was a founding member of the Islamic Insurance Association of London when it was launched in 2015, and Cobalt has received approval in principle for a new Lloyd's syndicate.

It remains to be seen how Brexit will affect the UK (re)insurance market, but steps are clearly being taken to open up the market to a new source of income, which is a potentially profitable one – reports consider the global Islamic insurance market to be worth tens of trillions of US dollars.

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England & Wales: IUA estimates Brexit's impact on premium written in the London market

The International Underwriting Association (IUA) has estimated that Brexit could hit £8.9 billion of premium written in the London market outside Lloyd's.

The IUA has published its London Company Market Statics Report 2017 in which it identifies two areas which it thinks will be impacted by the UK's withdrawal from the European Union: (1) company branches which passport into the UK from Europe to write international business coming into the London market; and (2) the UK-regulated London market companies which passport from the UK into Europe to write European business.

According to the IUA, a total of £7.383 billion is currently underwritten via branches of European-based firms which passport into the UK and £1.554 billion is earned by London market companies which passport into Europe.

Dave Matcham, the chief executive of the IUA, commented: "One of the most important outstanding Brexit questions for the London company market concerns the status of operations currently conducting business in the city as branches of either a continental European parent company or of a European subsidiary and with a parent elsewhere." As exit negotiations stand, passporting rights will be lost when the UK leaves the European Union, so alternative structures will be needed[1] if no deal is reached to preserve passporting in its current or a similar form.

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4. HFW PUBLICATIONS AND EVENTS

HFW partner named as leading lawyer in Who's Who Legal: Brazil

We are delighted to announce that **Geoffrey Conlin** has been named as a leading insurance lawyer in the latest edition of Who's Who Legal: Brazil.

USA: HFW attending ARIAS US 2017 Fall Conference

Partners **Christopher Foster** and **Costas Frangeskides** are attending the ARIAS US Fall Conference in New York on 2-3 November.

Jordan: HFW presenting to the Jordanian Insurance Federation

Partner **John Barlow** is presenting to members on the Jordanian Insurance Federation on 8 November on reinsurance issues for local insurers and cyber risks.

UK: HFW attending IRLA dinner

Partners and associates from the London office together with client guests are attending the annual IRLA dinner on Thursday 9 November.

El Salvador: HFW attending Fides Conference

Partners **Chris Cardona, Jonathan Bruce** and **Geoffrey Conlin** will be attending the Fides Conference in San Salvador from 12-15 November.

1 For further information, see HFW's briefing: http://www.hfw.com/Preparing-for-Brexit-seven-things-that-re-insurance-businesses-can-do-now-July-2016

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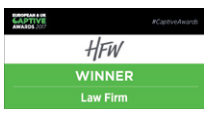

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