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Analysis

On 16 December 2008, the FSA published a feedback statement on "Transparency, disclosure and conflicts of interest in the commercial insurance market".

In this statement, the FSA identified five outcomes which are as follows:

- customers should have clear and comparable information about the commissions intermediaries receive;
- customers should have clear and comparable information about the services intermediaries are providing;
- customers should have clear information about the capacity in which an intermediary is acting;
- customers should be alerted to their right to request commission information; and
- customers should be made aware where there is a chain of intermediaries.

It is open to firms as to how they achieve each of these outcomes. If the outcomes are achieved, it is hoped by the FSA that this will ensure sufficient transparency so as to enable customers to make an informed decision about the insurance which they are considering buying. In turn, the FSA hopes that, over time, this may encourage more competitive and efficient distribution of commercial insurance.

The FSA has taken the view that no additional measures are required to address conflicts of interest, although it did note that the potential for conflicts is greater with some business models (for example, managing general agency arrangements).

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The FSA has particularly welcomed the industry guidance which is being developed as the FSA believes that an environment will then be created in which the process for arranging insurance can become more transparent.

The FSA will keep the whole matter under review but, for the time being, it has favoured a market-led solution. The good news no doubt for many intermediaries in the market is that the door to mandatory commission disclosure would appear to be firmly closed – at least for the time being.

Regulation

Solvency II

As part of the Solvency II project, the European Commission requested that the Committee of European Insurance and Occupational Pensions Supervisors ("CEIOPS") run a number of Quantitative Impact Studies to assess the practicability, implications and possible impact of the different alternatives considered. On 31 March 2008, the Commission provided guidance to CEIOPS on specific issues and asked CEIOPS to launch the Fourth Quantitative Impact Study on Solvency II (QIS4). In December 2008, the FSA published the UK results of the exercise which took place between April and July 2008.

The FSA found that most firms have a lower ratio of available capital to required capital under the proposed Solvency II specifications than under the Solvency I rules. Around 90% of the participating non-life firms have sufficient capital under QIS4 (compared to 80% under QIS3). However, it was noted that the capital requirements were significantly higher for annuity business in QIS4 than under Solvency I, largely due to the capital components for longevity, credit spread risks and the size of the risk margin.

The FSA also considered the level of resources required by different types of firms to implement Solvency II. They found that:

- generally companies using an internal model tend to anticipate higher one-off costs for Solvency II;
- with regard to on-going costs, the distinction between those that are planning to use an internal model and those that will not is less clear cut;
- the larger the organisation, the higher the Solvency II compliance costs tend to be (although many smaller firms noted that the execution of the QIS4 calculation represented a challenge); and
- irrespective of size, life insurers overall have to cope with higher costs than general insurers.

The FSA noted that 17 insurance groups participated in QIS4. The participants were broadly representative of medium and larger groups. The impact of QIS4 on groups mirrored many of the results at solo level. For example, groups exposed to annuity-business faced significant increases in financial requirements. The QIS4 exercise included variations to explore possible approaches to diversification within groups. On the basis of the comments received, the FSA stated that they would support Variation 2 for groups, allowing diversification for non-EEA business, but not allowing credit for diversification between ring-fenced with-profits business and other business.

The FSA also gave a clear indication that it considers that the implementation of Solvency II will still take place in 2012. Negotiations on the implementation proposals are ongoing in both the European Council and the European Parliament and should be concluded before March 2009, resulting in the adoption of the Level 1 Framework. In addition, nothing in the FSA's QIS4 report suggested that it will not be writing to (re)insurers in March 2009 asking them to confirm who is responsible for, and what progress they have made in, implementing Solvency II.

Consultation on amendments to rules on approved persons

On 19 December 2008, the FSA published a consultation paper on the extension of its approved persons regime, with particular focus on its expectations on those persons performing a 'significant influence' function, including senior management and non-executive directors. The consultation paper proposes to:

- extend the definition of 'directors' and 'non-executive directors' to include certain individuals in parent companies;
- make it clear that, in the future, the FSA will look more closely at non-executive directors where it believes that they have intervened more actively in a firm's management;
- extend the definition of 'significant management function' to include all proprietary traders where they can exert a significant influence over the firm;
- include in the regime UK branches of overseas firms based outside the EEA; and
- extend the rule obliging firms to provide references for applicants of the 'customer function' to all controlled functions if requested to do so.

The consultation period closes on 31 March 2009.

Regulation of connected travel insurance

With effect from 1 January 2009, the FSA has responsibility for regulating the intermediation of connected travel insurance. The list of firms authorised to conduct this activity currently comprises:

- Great Railway Journeys Ltd;
- Easy Travel & Tours Ltd;
- R.E. Bath Travel Service Ltd; and
- Eurotunnel Financial Services Ltd.

Rules on short selling

On 6 January 2009, the FSA announced that its rules prohibiting the short selling of securities in UK financial sector companies would be allowed to expire on 16 January 2009. The rules requiring disclosure of such provisions will, however, remain in place until at least 30 June 2009 (by which time, the FSA is expected to have consulted on more long term proposals).

Company/commercial

The Association of British Insurers ("ABI") has revised its guidelines on directors' authorities to allot shares in response to a call to do so from the Rights Issue Review Group. This Group was set up in the wake of a spate of rights issues in the first half of 2008 which highlighted certain problems with the current procedure for rights issues in the UK.

The revised guidelines have effectively doubled the amount of share capital that companies can issue in certain circumstances without seeking additional shareholder approval, which means that companies may be able to conduct rights issues in a shorter timeframe than at present.

The guidelines state that ABI members will continue to regard as routine (and, therefore, acceptable) resolutions seeking shareholder authority to allot shares up to an amount equivalent to one third of the company's existing issued share capital. They will also now regard as routine resolutions seeking shareholder authority to allot shares up to an amount equivalent to a further third of the company's existing issued share capital provided those extra shares are issued in fully pre-emptive rights issues, although the guidelines take up the safeguard suggested by the Rights Issue Review Group and state that ABI members may expect the board to offer itself for re-election if the additional authority is used in particular circumstances.

For a copy of the revised guidelines please click here.

International

Global Reinsurance Market

On 17 December 2008, the International Association of Insurance Supervisors ("IAIS") published a report on the Global Reinsurance Market. The report presents data acquired from a survey of reinsurers for the year 2007. In the report, the IAIS considers reinsurance market stability, linkages of the reinsurance sector, and the relationship between market turmoil and the reinsurance sector. The IAIS notes that reinsurers enjoyed a relatively calm environment and positive investment returns in the year 2007 to post high levels of profit, and that there was a 10% growth in the global reinsurance market measured by gross written premiums. The use of credit risk transfer devices grew rapidly during the period, despite the financial turmoil. Also, reinsurers suffered minimal losses in the lead up to and through the initial phases of the financial crisis although liability-side exposures to financial market volatility did challenge them.

European insurance market

On 22 December 2008, CEIOPS published a report on the financial stability of the European insurance market. Its findings were as follows:

- the financial market turmoil has reduced demand for life products significantly;
- 2009 is set to be an especially challenging year due to the consequence of a possibly prolonged period of a deteriorating macro-economic environment;
- during 2008 solvency provisions deteriorated and many companies have increased their capital buffers;
- 2008 was earmarked by higher catastrophe reinsurance losses than in the past. The 2008 hurricane losses as well as the financial turmoil will have an impact on demand prospects for reinsurance in 2009, the reinsurance capacity available, and consequently on prices for reinsurance cover;
- the insurance industry as a whole faces several risks and challenges going forward, and a prolonged period of economic recession will be particularly challenging for the underwriting performance;
- direct exposures to structured credit products remain limited in the sector; and
- further losses are likely if the negative developments in the commercial property markets continue but, on the whole, exposures appear to be manageable and should not jeopardise the solvency of insurers or pension funds.

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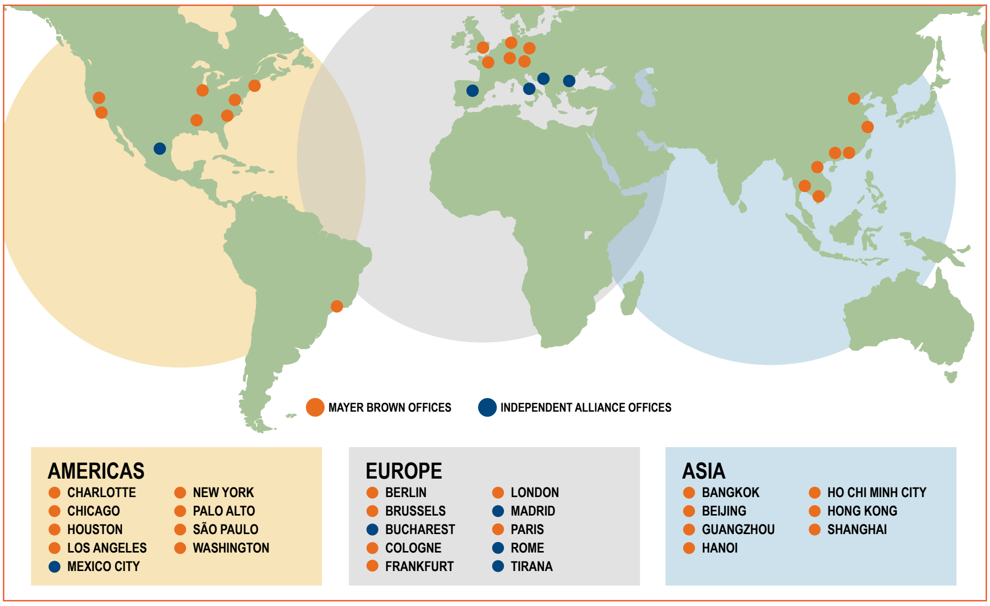

If you have any query in connection with anything in this Bulletin, please do not hesitate to get in touch with your usual Mayer Brown contact or one of the contacts referred to below.

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