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Status of Intermediaries

The Law Commission and the Scottish Law Commission have recently published a paper setting out their current policy in relation to whether an intermediary is to be treated as an agent of an insured or an insurer when it is transmitting pre-contract information from a consumer to an insurer. The Law Commissions intend to include this policy in a Bill which they are drafting on pre-contract information.

The significance of this issue is that, in circumstances where the intermediary has acted negligently or dishonestly in providing information to the insurer, where the intermediary is the agent of the insured, there is the possibility that the insurance policy could be avoided by the insurer to the detriment of the insured. This would not necessarily be the case, however, where the intermediary is the agent of the insurer. In the former case, the insured may have a right of action against the intermediary, but this could amount to scant consolation.

The Law Commissions have proposed that the intermediary is acting for the insurer if:

- the intermediary has authority to bind the insurer to cover; or
- the intermediary is the appointed representative of the insurer; or
- the intermediary has actual express authority from the insurer to collect pre-contract information on its behalf (for example, through an express term in a terms of business agreement).

In other cases, the intermediary is treated as acting for the insured unless there is "a close relationship between the intermediary and the insurer, so as to indicate that the insurer has granted the intermediary implied or apparent authority to act on the insurer's behalf."

In connection with this, the Law Commissions have provided an indicative and non-exhaustive list of factors that may be relevant.

Factors which indicate a close relationship include the following:

- the intermediary only places insurance with a limited number of insurers (the smaller the number of insurers, the greater the indication that the intermediary acts for the insurer);
- the insurer sells a particular policy through only a limited number of intermediaries;

- the insurer permits its policies to be branded with the intermediary's name, thereby representing that the consumer is dealing with an insurer rather than an intermediary.

The main thrust of the policy is welcome, but there is still a grey area in which it is not entirely clear how much weight to attribute to any particular factor and, consequently, how an intermediary is to be treated. To take one example where such uncertainty could arise, an intermediary arranges "white label" insurance branded in the name of a retailer and the intermediary places the insurance with a single insurer in circumstances where:

(i) such insurer is a party to a similar arrangement with a number of other intermediaries in respect of other retailers;

(ii) the intermediary in question is a substantial player in the "white label" market and, as part of its business, has dealings with a number of insurers; and

(iii) the intermediary does not have authority to bind the insurer in question to cover.

Conclusion of negotiations on Solvency II Directive (the "Directive")

Solvency II is part of the Commission's Better Regulation strategy. It will mean replacing 14 existing directives with a single directive. The negotiations on the Directive in the Council of the European Union and the European Parliament were concluded on 26 March 2009. The text of the Directive was formally approved by the European Parliament on 22 April 2009 and the Commission aims to have the new system in operation in 2012.

The Association of British Insurers (**"ABI"**) has noted its disappointment in the removal of the proposed group support regime from the text of the Directive, having previously stated that the response to the group support regime in the current economic climate "*must be to go forward, but to do so with care and intelligence*".

The proposed group support regime would have allowed an insurance group to recognise geographical diversification across the group, including from non-EEA subsidiaries. If excess capital can be identified and the proposed transferability criteria met, then this excess capital could have been used to cover capital needs elsewhere in the group. This proposed economic view of the balance sheet has, however, been excluded from the current agreed wording and will be revisited in a few years.

ABI key principles for regulatory reform

The ABI has published a discussion paper entitled "Regulation and Markets for the 21st Century". In this paper, the ABI set out five key principles, supported by the insurance industry, to help ensure that regulatory reform brings real benefits for consumers. The five principles are:

- **A safe and secure financial services system** – the ABI believes greatly enhanced co-operation between the Tripartite Authorities (the Financial Services Authority (**"FSA"**), HM Treasury and the Bank of England) is essential, but major structural change in the UK would be a distraction.

- **Prudentially sound firms** – the ABI believes that Solvency II must be adopted in Europe; supervision must be improved, although more box ticking is not the answer; regulators should better understand the business of firms; and supervisors must take into account macro-economic rules.
- **Competition and innovation** – the ABI wants the Financial Ombudsman Service to focus on arbitration, not policymaking. The ABI believes that competition drives down charges and promotes choice; therefore, regulators must find ways of preserving competition in the markets that deliver these benefits, whilst disincentivising unnecessary product complexity.
- **Regulation that works across borders** – the ABI supports the goal of creating an EU "supervisor of supervisors".
- **Capital markets that are connected to consumer needs** – the ABI calls for fair value to be preserved as the basis of financial reporting and for new steps to strengthen governance. A debate on the annual re-election of directors and the role of the chairman and the senior independent director, to strengthen governance, is also called for by the ABI.

For a copy of the discussion paper please click here.

Changes to the accounting standards dealing with Insurance Contracts

The Insurance Working Group is a specialist team of people put together by the International Accounting Standards Board (IASB) and the Financial Accounting Standards Board (FASB) to analyse accounting issues relating to insurance contracts. The Insurance Working Group has been particularly active recently and it would appear that further changes to insurance accounting standards are planned.

The Insurance Working Group is currently in the second phase of developing an IFRS (International Financial Reporting Standard) for insurance contracts. Stage one of the project resulted in the introduction of IFRS 4, but this standard was only ever intended to be an interim standard that permitted a wide variety of accounting practices for insurance contracts.

For stage two of the project, the Insurance Working Group intends to publish an Exposure Draft for a new standard in late 2009 with a final standard in 2011. Any comments on the Exposure Draft will be due by April 2010, although this timetable may be updated once the exact date of publication of the Exposure Draft is known. This new standard will replace the interim standard and will provide a basis for consistent accounting for insurance contracts in the longer term. The new standard is intended to apply to the accounting treatment of insurance contracts by policyholders as well as insurers.

FSA confirmation of proposed industry guidance

The FSA has confirmed in a letter dated 25 March 2009 that the British Insurance Brokers' Association (**"BIBA"**) proposed industry guidance on transparency, disclosure and conflicts of interest in the commercial insurance market received FSA confirmation on 24 March 2009.

The FSA will now allow BIBA to use the following wording in relation to this guidance, *"The FSA has reviewed this industry guidance and has confirmed that it will take it into account when exercising its regulatory functions. This Guidance is not mandatory and is not FSA Guidance. This FSA view cannot affect the rights of third parties."*

To view the entire FSA letter, please click here.

FSA's April 2009 edition of general insurance newsletter – Unfair contract terms

The FSA has reiterated that it *"expects all firms to have fair terms in their standard contracts with consumers. To have fair terms, firms need to comply with the requirements of the Unfair Terms in Consumer Contracts Regulations 1999 and the principle of Treating Customers Fairly. We expect firms to proactively review their contract terms and we encourage all firms to review other firms' published undertakings and consider their own contracts in line with them, where appropriate."*

The FSA has also confirmed that it is planning further reviews of contract terms after an initial review in December during which several firms were asked not to rely on certain terms with existing clients and to make amendments in contracts with new customers.

To view the entire FSA general insurance newsletter, please click here.

Joint International Association of Insurance Supervisors ("IAIS") and Organisation for Economic Co-operation and Development ("OECD") draft paper on insurer corporate governance

The IAIS and OECD have announced the release of a draft Issues Paper on Corporate Governance dated 13 March 2009 on which they are consulting. The purpose of the issues paper is to provide background on insurer corporate governance, describe practices and identify possible regulatory and supervisory issues. Please find a link to the issues paper attached.

The IAIS Governance and Compliance Subcommittee and the OECD Insurance and Private Pensions Subcommittee jointly drafted the issues paper. The two bodies took into consideration the OECD Guidelines on Insurers' Governance and existing work within the IAIS-OECD roundtable held in Paris in December 2008, in addition to the supervisory experience of the members of the subcommittee.

The IAIS and OECD state that the aim of the issues paper is not to present proposals or recommendations, but rather to inform further considerations by the IAIS and the OECD in describing important components of an insurer's corporate governance framework.

Interested stakeholders are invited to submit comments on this draft issues paper by 30 April 2009. A summary report on the survey responses will be made available.

The Turner Review – 32 steps to a stable banking system?

The FSA published the Turner Review of global banking regulation (the **"Review"**) on 18 March 2009. The Review highlights 32 actions which the Chairman of the FSA considers are required to create a "stable and effective" banking system. Many of these actions are already underway or have been implemented; others are only achievable through international co-operation.

The potential significance of the Review for the insurance market is that some of the actions highlighted could also be taken in respect of the insurance market, (for example, in respect of supervisory approach – see further below).

The Review is split into an analysis of the causes of the current crisis, a set of specific policy measures, and some open questions for industry debate. Highlights from amongst the policies include:

- **Supervisory approach -** the FSA will become "more intrusive and more systematic" in its supervision of firms. This has, to an extent, already commenced with the introduction of the Supervisory Enhancement Programme for higher risk or more complex firms. What we may see is the FSA taking a greater interest in management decisions and processes and in analysing accounting practices within firms.
- **Credit Rating Agencies** (**"CRAs"**) **-** CRAs should be subject to registration and supervision to ensure good governance and management of conflicts of interest and to ensure that credit ratings are only applied to securities for which a consistent rating is possible. The European Commission draft regulations address many of the points the Review highlights (such as management, conflict of interest and governance) and are anticipated to be approved in April 2009, although as the Review acknowledges, one cause of the financial crisis was a mistaken assumption that a rating "carried an inference for liquidity and price stability" rather than credit risk alone.
- **Deposit insurance -** retail deposit insurance should be sufficiently generous to ensure that the vast majority of retail depositors are protected against the impact of bank failure. This has already been implemented in the UK. However, clear communication should be put in place to ensure that retail depositors understand the extent of deposit insurance cover.
- **Product regulation -** the FSA has promised a further consultation on additional regulation of the mortgage industry which is scheduled to be published in September. The FSA has, however, flagged that it does not see direct product regulation generally as being inappropriate in principle.

The review also asks some open questions regarding product regulation, whether additional counter-cyclical tools should be available, and whether liquidity should be balanced against stability. These questions are in keeping with the FSA's general position that it "would not rule anything out". For a copy of the Turner Review please click here.

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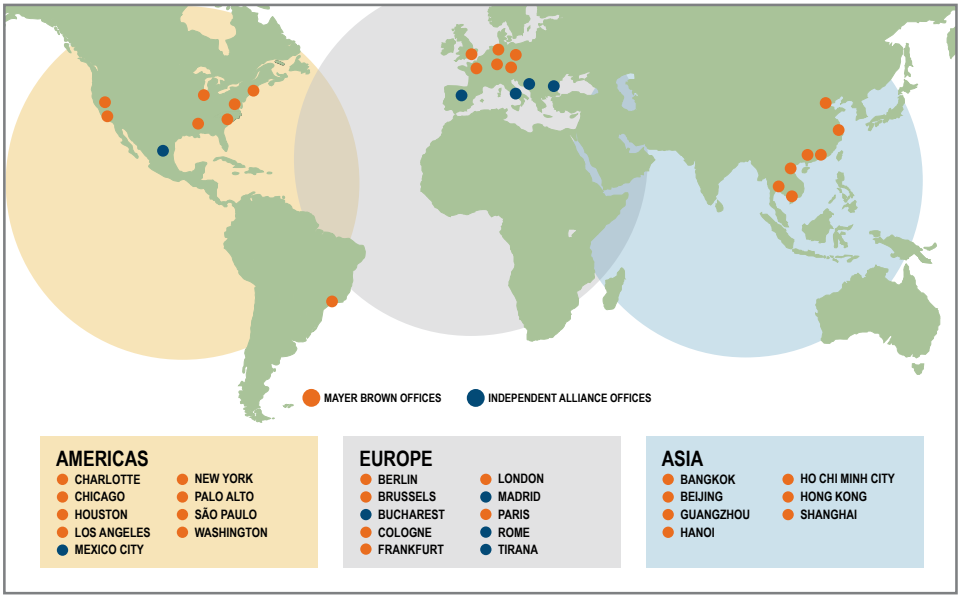

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