MAYER • BROWN

Article

This article first appeared in a slightly different form in *EuroWatch*, 31 July 2009

CORPORATE INSURANCE & REGULATORY BULLETIN

By Martin Mankabady, Jane Childs, Alistair Bird, Angela Hayes and Karen Abbott

HM Treasury's "Vision for the UK insurance industry in 2020"

On 27 July 2009, the Insurance Industry Working Group ("IIWG") published a well publicised report providing its views and recommendations on how the medium to long-term challenges and opportunities facing the insurance sector should be met.

In the report, the IIWG has agreed a vision for the UK's insurance industry in 2020. The IIWG wants "the UK to be the leading global insurance centre with an unsurpassed reputation for excellance, a deep and constructive relationship with its customers and a close and effective partnership with Government".

The IIWG recommendations to achieve this vision are underpinned by the following four main themes:

1. creating a more customer-focused approach to increase customers' confidence and trust in the insurance industry (as well as furthering customers' awareness of their own personal responsibility);
2. producing a broad range of risk management solutions, which provide customers with the products they need at a competitive price;
3. for the insurance industry to act in partnership with the Government to explore options to increase savings and protection provision and to help consumers manage financial distress; and
4. ensuring the UK insurance industry's competitive position in the global marketplace is maintained and enhanced, and that capital can earn a competitive return, in order to encourage capital flows into the UK insurance industry.

To view the entire IIWG report, please click here.

FSA proposes bigger fines in enforcement cases as part of its drive to achieve "credible deterrence"

On 6 July 2009, the FSA published a Consultation Paper (CP 09/19) setting out proposals to change its current policy on the determination of the level of financial penalties in enforcement cases.

The proposed new framework for setting penalties is designed to achieve both transparency and consistency, and also to increase the overall level of penalties imposed. The FSA says that there needs to be an increase in the size of penalties in order to change behaviour and to address concerns that firms are repeatedly failing to improve standards, particularly in relation to misselling to consumers and market misconduct.

Martin Mankabady *and* **Alistair Bird** *are partners in the Corporate Group,* **Jane Childs** *and* **Karen Abbott** *are partners in the Insurance & Reinsurance Group and* **Angela Hayes** *is a partner in the Financial Services Group at Mayer Brown international LLP.*

Under the new proposals, fines will be linked more closely to income and will be based on:

- up to 20% of the company's income from the product or business area linked to the breach over the relevant period;
- up to 40% of an individual's salary and benefits (including bonuses) from their job relating to the breach in non-market abuse cases; and
- a minimum starting point of £100,000 for individuals in market abuse cases.

The total fine imposed will also take into account other factors, including the desired deterrent effect. The FSA is not proposing to make changes to its current policy on discounting financial penalties for early settlement.

The FSA has been signalling its intention to increase the level of its fines for some time now and they have been gradually creeping upwards, particularly in misselling cases. Nevertheless, the focus on a proportion of income as the starting point for levying a financial penalty, which will apply in addition to disgorgement of any profits made, will involve a significant step change in the level of FSA fines. This will be most keenly felt by individuals facing personal fines and comes at a time when the FSA has stepped up its campaign to hold individual senior managers responsible for compliance breaches.

The consultation will close on 21 October 2009 and any new policy is likely to apply to breaches committed after February 2010.

Lloyd's strategic review

Lloyd's of London has commenced a strategic review in an attempt to ensure the insurance market does not fail to exploit the gaps in the market which have resulted from the financial crisis.

Traditionally, Lloyd's has operated a strategic three-year rolling plan. The plan sets out the key priorities which are then reviewed and tested on an annual basis. The CEO of Lloyd's has stated that the fundamental review will go beyond the annual update of the three-year plans and will involve input from all stakeholders. The review will examine Lloyd's product, distribution and geographical mix. Deloitte have been brought in to assist with the review and Lloyd's are hoping to publish the new strategic plan in early 2010.

The last strategic plan was published in December 2008 (the three year 2009-2011 plan) with the aim of improving underwriting discipline, the proposed risk-based capital regime for insurers and reinsurance in the EU, and claims performance and influencing the passage of Solvency II.

Lloyd's has also recently expanded internationally with offices in Singapore and Brazil.

Solvency II – CEIOPS releases its second set of advice on Solvency II Level 2 Implementing Measures.

On 12 June 2009, the European Commission requested that the Committee of European Insurance and Occupational Pensions Supervisors ("CEIOPS") provide final advice (which had been the subject of full consultation) on the vast majority of Solvency II Level 2 implementing measures by October 2009 (with the remaining advice to be finalised by January 2010). The European Commission also recommended that CEIOPS develop, in the same timescale, the Level 3 guidance on certain areas with the aim of fostering supervisory convergence.

On 2 July 2009, CEIOPS released for consultation its second set of advice papers, which was developed on the basis of the Solvency II Level 1 text (which was approved by the European Parliament on 22 April 2009). Comments received from the insurance sector on the first set of advice papers on Level 2 measures are currently being processed, and the third set is due to be released at the beginning of November 2009.

CEIOPS' second set of advice papers invite comment on the group internal model; the actuarial and statistical methodology (including the use of capital add-ons, choice of discount rate, and the calculation of technical provisions); the risk margin; standards for data quality; the Solvency Capital Requirement standard formula; reporting and disclosure; group solvency assessment; intra group transactions and risk concentration; and co-operation and colleges of supervisors.

Solvency II – CEIOPS publishes advice on remuneration issues for Solvency II Level 2 Implementing Measures

On 21 July 2009, CEIOPS published advice for the European Commission in relation to remuneration issues for Solvency II Level 2 implementing measures. The paper aims to provide advice on the remuneration practices applied to the administrative or management body and senior management of financial entities, and personnel undertaking activities that involve risk taking.

CEIOPS recommends 6 principles which should be applied by the Commission:

1. an overall remuneration policy that is in line with the undertaking's business and risk strategy, risk profile, objectives, values, risk management practices, and long-term entity-wide interests and performance should be adopted;
2. the remuneration policy should apply to the undertaking as a whole in a proportionate and risk-based way and contains specific arrangements that take into account the respective roles of the administrative or management body, senior management and personnel undertaking activities that involve risk taking;
3. there should be a clear, transparent and effective governance structure around remuneration, including the definition of the remuneration policy and its oversight, while assessing the undertaking's benefits and risks with a forward-looking perspective;
4. when remuneration schemes include both fixed and variable components, these should be appropriately balanced so that the fixed component represents a sufficiently high proportion of the total remuneration to allow the undertaking to operate a fully flexible bonus policy - the payment of the major part of a significant bonus, irrespective of the form in which it is to be paid, should contain a flexible, deferred component that considers the nature and time horizon of the undertaking's business;
5. when defining an individual's performance, other factors apart from financial performance should be considered - the measurement of performance, as a basis for bonus awards, should include an adjustment for current and future risks, taking into account the undertaking's risk profile, and cost of capital for members of the administrative or management body, the senior management and personnel undertaking activities that involve risk taking; and
6. the remuneration policy should be transparent internally and adequately disclosed externally.

The end of public data ratings for UK insurers

On 10 July 2009, A.M. Best announced that it had discontinued public data ratings of UK insurers. Instead, interactive ratings will be used. As a consequence, the financial strength and issuer credit ratings of 42 UK insurers have been withdrawn.

A public data rating was an opinion of the financial strength of an insurer. In common with interactive ratings, this involved analysis of balance-sheet strength, operating performance and business profile. However, the analysis did not generally involve interaction with company management.

In contrast, interactive ratings are produced at the request of the insurer. The rating process includes detailed interviews with senior management and, typically, access to non-public data and other information. Analysis of issues that typically would have limited distribution in the public domain plays a significant part in the interactive rating analysis (for example, detailed information on management strategy, earnings forecasts, reinsurance protections and reserving methodology).