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# Insurance & Reinsurance Industry Group: Corporate Insurance & Regulatory Bulletin - London

## Financial Services Authority ("FSA") Speech – UK Financial Regulation – After the crisis

The FSA has published a summary of a speech made by Hector Sants, the Chief Executive of the FSA, at the annual Lubbock lecture in management studies on 12 March 2010. In his speech, Hector Sants discussed the following two points: (1) what the FSA is doing differently following the crisis; and (2) his personal perspective on what the critical unresolved issues, are and the remedial action which is required.

Although Sants' speech concentrated on issues related to the banking crisis, the speech did include several general statements regarding changes at the FSA which will apply equally to any other FSA regulated entity. Commenting on the FSA's new operating model, Sants stated that:

*"In summary, our new approach to conduct seeks to achieve three goals:*

- *making the retail market work better for consumers;*
- *avoiding the crystallisation of conduct risks that exceed our risk tolerance; and*
- *delivering credible deterrence and prompt and effective redress for consumers.*

*The mechanism for achieving this has three key strands:*

- *first, seeking to improve the long-term efficiency and fairness of the market;*
- *second, delivering intensive supervision of firms. The new supervisory approach will ensure firms treat their customers fairly and will equip the FSA to intervene earlier in the development of retail products. Interventions of this nature, which necessarily involve us making a judgement on potential detriment, will need to be based on sound business-model analysis and integrated firm-risk assessment; and*
- *third, in the event that failure has occurred, we will secure the appropriate level of redress and compensation (when justified), and achieve effective credible deterrence by taking tough action against firms and individuals who have transgressed."*

All FSA regulated entities will need to be aware of the new approach adopted by the FSA and keep under review how the FSA implements it. To view the full text of Hector Sants' speech, please click here.

## FSA Speech – What are the key risks facing the insurance sector?

The FSA has published a summary of a speech made by Ken Hogg, Director of the FSA's insurance sector, at the insurance sector conference on 18 March 2010. In his speech, Ken Hogg discussed the recent publication by the FSA of its Financial Risk Outlook, and Sector Digests, which give extra focus to the risks specific to each financial sector. The purpose of Hogg's speech was to highlight the key insurance risks from these reports and to explore a few of the steps which insurers could take to mitigate these risks.

The first set of risks which Ken Hogg discussed relate to capital and solvency, together with the different impact of these issues on the life and non-life sectors during the recent economic downturn. Commenting on these risks, Hogg highlighted that:

*"Firstly, it's about monitoring your solvency position. Conditions can change very quickly and being slow to realise what's happening and slow to respond could make a big difference to both the capital conserving options available and the opportunity cost – to shareholders and policyholders – of taking those actions....regular and ongoing stress testing is an important part of planning ahead.*

*Secondly, you need to exercise care in the valuation of assets and liabilities, and ensure they are appropriately* *matched by duration. Annuity providers in particular remain exposed to renewed widening of bond spreads".*

The second set of risks highlighted by Ken Hogg related to consumers' behaviour, including changes to consumer demand and the propensity for increases in claims, and the different issues which will effect the life and non-life insurance sectors as a consequence.

Ken Hogg ended his speech by exploring the risks associated with the high level of change and uncertainty in the current regulatory environment and noted that a considerable number of policy changes, such as the Retail Distribution Review, pension reform under the National Employment Savings Trust, and Solvency II, aim to be implemented in 2012.

To view the full text of Ken Hogg's speech, please click here.

## A new competition law framework for the insurance sector: the Commission's new block exemption

On 24 March 2010, the European Commission (the **"Commission"**) published a new Insurance Block Exemption Regulation (**"IBER"**) to replace existing Regulation 358/2003/EC, which expires on 31 March 2010.

The revised IBER will significantly restrict the types of co-operation among insurers and reinsurers which are automatically exempt from EU and national competition rules. Insurers will have a six month grace period until 1 October 2010 to assess whether existing arrangements qualify under the new IBER.

IBER will continue to exempt only two categories of co-operation arrangements:

- the establishment and distribution of joint calculations, tables and studies; and
- the establishment and operation of co-insurance and re-insurance pools.

Companies can now only jointly compile and distribute the information that is necessary to make average cost calculations. In addition, only the joint compilation and distribution of information necessary for the construction of mortality and other life tables will fall within the block exemption.

Compilations, tables or study results must be made available on affordable, reasonable and non-discriminatory terms to any insurance undertaking and, unless non-disclosure is justified on grounds of public security, to any interested third party requesting a copy. The tables must also not contain any indication of the level of commercial premiums.

Subject to certain conditions, the revised IBER covers agreements entered into between two or more insurance undertakings with respect to the setting-up and operation of pools of insurance and/or reinsurance undertakings for common coverage of a specific category of risks in the form of coinsurance or co-reinsurance.

Reflecting previous concerns of the Commission (to view the Sector Inquiry of the Commission, please click here), the IBER will not apply to ad-hoc co-insurance or co-reinsurance arrangements in the subscription market, where a certain part of a given risk is covered by a lead insurer and the remainder is covered by follow insurers.

Market share figures have been amended to include market shares held by the participating undertakings outside a pool. This is likely to mean that a number of pools previously exempt under the existing IBER may no longer be exempt and will need to be assessed individually for their compatibility with applicable competition rules.

The revised IBER sees a 3% rise in the flexibility percentage for market share thresholds below which the exemption will apply, rising from 22% to 25% for co-insurance pools and from 27% to 30% for co-reinsurance pools.

The Commission has revised the definition of new risks, reflecting industry concern that the uncertainty surrounding the existing definition hinders pools with innovative policies.

The IBER does not renew the exemptions for standard policy conditions for direct insurance (**"SPCs"**) and security devices on the basis that they are not insurance-specific, although these may be covered in revised Horizontal Guidelines. To view details of the public consultation, please click here.

Accordingly, from 1 April 2010, companies will need to make a competition assessment regarding any contemplated agreement or co-operation in relation to SPCs or security device standards.

The new IBER comes at a time of similar change in the United States. This could see insurers' and reinsurers' antitrust risks increasing significantly in both the EU and US, creating pressure for companies to assess the extent to which their current agreements and practices comply with competition law.

## Solvency II – CEA report on why excessive capital requirements harm consumers, the economy and insurers

This month, the European insurance and reinsurance federation (**"CEA"**) published a report on the financial requirements of Solvency II and the costs and risks arising from excessive capital requirements.

The CEA has strongly endorsed and fully supported the development of the Solvency II regulatory regime, and sees it as a positive step forward for insurance sector regulation. However, it notes that overly prudent or excessive capital requirements might have a downside for policyholders, the overall economy and insurers. According to some recent estimates, the required solvency capital under Solvency II could be as much as 65-75% higher then the standard model calibration under the fourth industry wide quantitative impact study, and represent an additional capital burden of 30-50% on the sector.

The CEA believes that placing excessive capital requirements on the insurance industry would mean that: (1) individual insurance companies may increase the price of more capital intensive products, reduce policyholder coverage and benefits, and reduce underwriting capacity on the most affected lines; (2) the insurance industry as a whole could see reduced investor returns, which may trigger a reduction in new capital investments, reducing in turn the underwriting capacity in the industry, and increasing funding costs, which may put European insurers at a disadvantage in the global market; and (3) policyholders may suffer an increase in the price of cover (particularly for life products), retirement funds may go down, and products may be redesigned.

## What's coming up – Corporate Insurance & Regulatory Seminar on Regulation: trends and developments

In recent times, the spotlight has shone more brightly on regulation and, in particular, whether regulatory regimes and the regulators which supervise them are fit for purpose. In response to this, many regulators have adopted a more intrusive, risk averse manner.

On 13 April 2010, Mayer Brown's Insurance Industry Group will be hosting a seminar that will consider some of the key regulatory trends and developments affecting the UK insurance market.

The format will be a panel discussion chaired by Martin Mankabady, who is head of our Corporate Insurance & Regulatory team. Martin will be joined on the panel by Partner Angela Hayes and Senior associates Matt Baker and Sarah Russell.

There will also be an opportunity for an interactive panel discussion in which questions can be asked of the panel.

Some of the key areas to be covered will include:

- the prospects for the FSA if a new government is elected;
- the likely impact of Solvency II on the insurance market; and
- the current approach of the FSA.

We very much hope that you will be able to join us for this breakfast session. Further details regarding location, timing and who to contact to register for this session are detailed below.

Tuesday, 13 April 2010
Registration: 8:30 a.m.
Presentation: 8:45 a.m. - 9:45 a.m.

Mayer Brown International LLP
201 Bishopsgate
London, EC2M 3AF

For questions regarding the programme or to register, please contact Hana Sedlackova at hsedlackova@mayerbrown.com or +44 20 3130 8349.

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 the contact referred to below.


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