MAYER • BROWN

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China – CIRC allows overseas investments by Chinese domestic insurers

On 12 October 2012, China's Insurance Regulatory Commission (**"CIRC"**) issued the Implementing Rules for the Interim Measures, which has the effect of widening overseas investment options for Chinese domestic insurers. Whereas previously they were permitted to invest only in Hong Kong, now they are permitted to allocate assets in 45 new countries, including 25 developed and 20 emerging markets.

The scope of approved asset classes has also been widened. Chinese insurers may now invest in offshore products in the following categories: equities, bonds, currency products and fixed income products as well as real estate and offshore private equity funds.

It remains unchanged that the total offshore investments by Chinese insurers should not exceed 15% of their total assets by the end of the previous year. The recent rules further provide that the total investments in the 20 emerging market jurisdictions should not exceed 10% of the insurer's total assets by the end of the previous year.

This move is the most recent among a series of policy amendments directed this year at boosting the profitability of China's insurers.

For further information, click here for our full article: "New CIRC Rules Aimed at Expanding China's Overseas Insurance Investment" and click here for our previous article: "CIRC Relaxes Restrictions on Permitted Investments by Insurance Companies".

UK – FSA moves to internal twin peaks model for authorisation

Following the FSA's adoption in April 2012 of an internal twin peaks model for supervision, on 15 October 2012 the FSA published a statement announcing the implementation of an internal twin peaks model for authorisation. This will only affect firms that will be dual regulated under the new regulatory structure (due to be implemented in April 2013), with such firms now being subject to assessment by both the Prudential Business Unit and the Conduct Business Unit. The FSA has said that this will only change how applications are processed internally, i.e. the submission process will not be affected.

UK – Lloyd's Market Association updates Contract Certainty Code of Practice

On 15 November 2012, the Lloyd's Market Association (**"LMA"**) published an updated version of the Contract Certainty Code of Practice (the **"CCCP"**), which applies to general insurance contracts entered into by a UK regulated insurer or arranged through a UK regulated broker.

The revised CCCP reflects changes to the regulatory structure and addresses some minor inconsistencies that existed in the previous version, but the substantive guidance is unchanged.

Europe – Solvency II update

Timing

There is ongoing concern that Solvency II will not be ready in time for the intended full implementation date of 1 January 2014, with Gabriel Bernardino (chairman of the European Insurance and Occupational Pensions Authority (**"EIOPA"**)) suggesting the best case scenario is implementation in either 2015 or 2016, with 2016 considered more likely.

This concern is compounded further by the announcement on 30 November 2012 that the European Parliament will now not consider Omnibus II until its 10-13 June 2013 plenary session (this was previously scheduled for March 2013). Until Omnibus II is finalised, the detailed Level 2 and 3 text cannot be finalised.

Some market participants consider this ongoing uncertainty to be damaging to the EU's reputation – in particular, Gabriel Bernardino has expressed concern that "*the lack of certainty about Solvency II implementation is challenging the EU's credibility in international discussions*". Mr Bernardino has said that strong commitment from the EU institutions is needed in order to determine "*a clear and credible timetable based on a realistic assessment of the expected time needed to deliver the different milestones of the regime*".

Technical developments

On 18 October 2012, EIOPA published Technical Specifications for the Solvency II valuation and Solvency Capital Requirements calculations Part I. This is a working document that EIOPA recommends should be used by insurance and reinsurance undertakings in quantitative assessments. The updated technical specifications have been published in order to help participants in the upcoming Long Term Guarantee Assessment to better prepare for the exercise. However, this first part of the updated technical specifications contains only general specifications, with the long term guarantee related specifications due to be published by EIOPA in due course.

FSA developments

The FSA has reminded firms that an approval to use an internal model for individual capital adequacy standards (**"ICAS"**) purposes does not constitute approval to use that model for Solvency II purposes and that Solvency II models can only be approved once legal powers are granted to the FSA under Solvency II. The FSA has said it is aware of the need to optimise resources and avoid duplication of work and that it will therefore consider approval to use Solvency II work for ICAS requirements on a firm by firm basis.

The FSA has also updated its webpage on submissions under the FSA's internal model approval process for Solvency II. The revised webpage includes a link to an updated self-assessment template for use by firms and the FSA has reminded firms that they are required to demonstrate that they meet the requirements of Solvency II and its implementing measures in order to obtain internal model approval. The FSA has also published a letter regarding the use of early warning indicators as part of the monitoring process for the ongoing appropriateness of internal models.

Europe – EIOPA report on insurance industry training standards

On 9 October 2012, EIOPA published a report on the knowledge and ability requirements set by EU national competent authorities (**"NCAs"**) for insurance intermediaries. The report is based on responses to a mapping exercises carried out by EIOPA members between March and September 2012 on the industry training standards that apply in difference jurisdictions.

The report concluded that knowledge and ability requirements are generally a combination of academic and professional experience, although in some countries academic qualifications can be waived if professional experience is long enough. In many member states, the requirements for insurance brokers are more stringent than for insurance agents.

The report also indicates that the requirement to update knowledge and ability requirements through continuous professional development (**"CPD"**) varies considerably between jurisdictions, with some jurisdictions only assessing knowledge and ability before first registration of an intermediary while other jurisdictions require a minimum number of hours of CPD per year or require the passing of exams or training courses on a regular basis. With a few exceptions, there is limited availability for intermediaries to update their knowledge and ability via e-learning.

In addition, responsibility for assessing knowledge and ability at a national level was found to vary considerably. Some jurisdictions only permit assessment by the NCA, or by the NCA in tandem with undertakings/professional associations, while others delegate this responsibility to professional associations and some delegate this responsibility to the intermediary or undertaking itself.

The report found that NCAs had very little experience of receiving applications for mutual recognition of knowledge and ability requirements.

Finally, sanctions for failure to possess adequate knowledge and ability were found to vary; the basic sanctions are refusal to register the intermediary or a withdrawal of the intermediary's licence/authorisation, but some jurisdictions have more stringent regimes, involving suspensions, disqualifications, fines or imprisonment.

Europe – European Parliament publishes working document on IMD II

On 29 October 2012, the European Parliament published a working document on the European Commission's proposed Insurance Mediation Directive II (**"IMD II"**). This document raises a number of issues that the European Parliament believes need to be considered, including:

- whether the appraisal of claims should be included within the scope of IMD II;
- the fact that the European Commission's proposal provides for a number of delegated acts, which would lead to maximum harmonisation in certain important areas;
- the resources that will be allocated to EIOPA to enable it to perform the tasks conferred on it under those delegated acts;
- whether insurance investment products are actually comparable with pure investment products and should therefore be subject to the same rules;

- whether a fee-based system for the mediation of insurance investment products would actually translate into better advice to customers; and
- the technical difficulties arising from the provisions on conflicts of interest and transparency.

The European Parliament is currently scheduled to consider IMD II at its plenary session on 20-23 May 2013.

US – Pension and insurance convergence

As evidenced by recent pension de-risking transactions involving GM ($26 billion), Verizon ($7.5 billion) and Ford (potentially $18 billion), pension de-risking by extinguishing plan liabilities is emerging as a critical theme among defined benefit (pension) plan sponsor companies of all sizes.

Over the last several years, plan sponsor concerns regarding volatility in pension obligations have been heightened by changes in accounting and funding rules, as well as by volatile capital markets, a low interest rate environment and longevity risk issues. Many defined benefit plan sponsors have frozen defined benefit plans to new hires, or frozen benefit accruals completely. Some sponsors of both frozen and ongoing plans have sought to reduce the volatility of their pension obligations by pursuing in-plan investment strategies, which include the use of swaps and derivatives, as well as strategies such as "immunization" or "liability driven" investing—or the purchase of annuity contracts held by the plan as an investment. None of these approaches settles or extinguishes the plan's liabilities and the sponsor remains liable for Pension Benefit Guaranty Corporation (**"PBGC"**) premiums with respect to those benefits.

Sponsors may extinguish plan liabilities through a complete plan termination, but this is often not feasible or desirable due either to employee relations issues or the requirement that the sponsor fully fund the plan as a condition of a standard termination.

More recently there appears to be increasing plan sponsor interest in the selective settlement of plan obligations through the use of "buy-out" annuities for, or offering lump sums to, certain segments of the plan population (both in the context of an ongoing plan or frozen plan, or a spin-off/termination). This increase may be as a result of (i) concerns regarding the relative success/expense of de-risking by plan investment strategies, (ii) recent private letter rulings by the IRS that provide helpful guidance on the use of lump sums and annuities to settle pension obligations, (iii) certain changes in the funding rules made by 2012 legislation known as **"MAP-21"**[1] that make it less expensive for plan sponsors to maintain target funding ratios even after settling a segment of pension liabilities, (iv) increases in PBGC premiums enacted by MAP-21, (v) the possible revision of mortality tables used by pension actuaries to reflect longer life expectancies and (vi) the examples of GM, Verizon and Ford transactions.

1 Moving Ahead for Progress in the 21st Century Act

- Verizon recently announced that it has entered into an agreement to transfer $7.5 billion in pension liabilities to Prudential. The transfer will be achieved through the purchase of a group annuity contract under which Prudential will assume the obligation to make annuity payments to 41,000 management retirees who retired prior to January 2010; the transaction is expected to close in December 2012, subject to final review and approval by an independent fiduciary for the plan.
- Earlier this year, GM announced that it would spin-off the portion of its plan covering active and some former employees. Most retirees would remain in the existing plan, which will then be terminated. In the course of the plan termination certain retirees will be offered the choice of a lump sum distribution of the value of their remaining benefits. The benefits of those who do not elect a lump sum (and the benefits of certain retirees who will not be offered a lump sum) will be transferred to Prudential. GM estimates that its actions will reduce its pension liabilities by $26 billion.
- Under the de-risking program announced by Ford, 90,000 retired and terminated vested participants may elect to have their benefits distributed to them in the form of a lump sum distribution. For those who do not elect a lump sum, no annuities are being purchased from an insurer at this time. It has been reported that the lump sum offering could reduce Ford's pension obligations by up to $18 billion.

For many years, the buy-out annuity market has been valued at approximately $2 billion per year. That changed with the announcements by GM and Verizon, and a number of consultants are predicting that the pace of buy-out annuity purchases will accelerate in the United States (as we have already seen happen in the United Kingdom), particularly if interest rates go up even slightly.

The implementation of de-risking strategies, including the structuring and negotiation of insurance contracts with respect to ongoing, frozen or terminating plans, offering lump sum distributions to individuals in pay status, and the use of novel investments can be incredibly complex and, in addition to the difficult financial calculus, may involve insurance law, tax, qualified plan, accounting, and ERISA fiduciary issues. Companies interested in implementing such strategies are advised to seek experienced counsel.

US – NAIC takes major step toward implementation of principles-based reserving for life insurers

The National Association of Insurance Commissioners ("NAIC") voted on 2 December 2012 to approve a new Valuation Manual containing details of a "principles-based" rather than a "formula-based" approach to life insurance company reserves. The vote was 43 to 8 – one vote more than the 42-vote supermajority that was required for adoption. Among the "no" votes were the insurance commissioners from the two commercially important states of California and New York.

The stated goal of "principles-based reserving" (**"PBR"**) is to make greater use of assumptions and judgment to produce a reserve calculation that is more aligned with the risks in today's complex life and annuity products. Proponents of PBR contend that it will tailor the reserving process to specific products, rather than using a "one size fits all" approach that can lead to over- or under-reserving. They say that PBR will reduce redundant reserves for some products and increase inadequate reserves in other cases where significant product risks may not be adequately reflected under the current formula-based approach. They further suggest that reductions in redundant reserves will not only benefit insurers but will also make life insurance products more affordable for consumers. Critics point out that PBR will be more complicated to apply and more difficult for insurance department staff to oversee. Many critics further contend that there will be an overall reduction of reserves under PBR that will diminish the security of policyholders and lead to an increase in insurer insolvencies.

The NAIC vote on 2 December 2012 was just a milestone in a process that began in 2004 when the Life Practice Council of the American Academy of Actuaries first recommended the use of PBR to the NAIC's Life and Health Actuarial (A) Task Force. The reason the NAIC vote is just a milestone is that the new Valuation Manual (and the PBR approach it contains) will not become effective unless it is enacted into law by legislatures in at least 42 states representing more than 75% of US direct premiums written for life, annuities and health insurance. That process could take years – and might not be successful at all. The insurance commissioners of California and New York have expressed strong opposition to PBR in its present form, and a number of other state insurance commissioners – including in the important state of Texas – have indicated that while they voted for the Valuation Manual at the NAIC level in order to move the process forward, they are not prepared to support its legislative enactment in their states without further study of the impact of PBR and how the transition to PBR would be handled.

Recognizing the need for further study, the NAIC voted to form a Joint Working Group of the Life Insurance and Annuities (A) Committee and Financial Condition (E) Committee to oversee the study process and address critics' concerns. The membership of the Working Group is expected to be appointed in January 2013 and will include consumer representatives. It is likely that the insurance commissioners in many states will wait for the results of the Joint Working Group study before seeking approval of the Valuation Manual from their respective legislatures.

US – NAIC subgroup holds public discussion of draft white paper on captive and special purpose vehicle use

The NAIC Captive and Special Purpose Vehicle Use (E) Subgroup held a public meeting on 29 November 2012 at one of the sessions of the NAIC National Meeting held near Washington, DC. The purpose of the session was to discuss comments received on the draft White Paper the Subgroup had issued on 16 November 2012.

The Subgroup was formed in early 2012 by the NAIC Financial Condition (E) Committee to study the use of captives and special purpose vehicles (**"SPVs"**) to transfer policyholder risk, as distinct from self-insured risk, and to recommend regulatory responses.

According to the draft White Paper, the Subgroup determined that the majority of cessions to captives and SPVs by commercial insurers are reinsurance transactions used by life insurance companies to finance reserves required by Regulations XXX and AXXX that the companies perceived to be "redundant". Among the structures utilized to finance such reserves are:

- captives as a conduit to securitizations that provide capital market financing of redundant reserves;
- captives capitalized by letters of credit accounted for as assets in support of redundant reserves; and
- captives or SPVs capitalized by parental guarantees accounted for as assets in support of redundant reserves

The Subgroup's draft White Paper made recommendations in five areas:

1. **Accounting considerations**

   While recognizing the need to deal with perceived XXX and AXXX reserve redundancies, the consensus of the Subgroup was that it is inappropriate for captives and SPVs to be used as a means to avoid statutory accounting. The Subgroup expressed the view that it would be more appropriate to deal with accounting and reserving issues within the ceding company, thereby eliminating the need for a separate transaction outside of the commercial insurer. (See the separate article on "principles-based reserving" in this bulletin.) The Subgroup suggested that the NAIC also consider modifications to the statutory accounting framework to recognize, in limited situations, alternative assets, such as "tier 2 type assets" to support specific situations (e.g. less likely to develop liabilities), thereby eliminating the need for a separate transaction outside of the commercial insurer.

2. **Access to alternative markets**

   The draft White Paper expressed support in principle for the availability of solutions designed to shift risk to the capital markets or provide alternative forms of business financing. The Subgroup noted that the NAIC's Special Purpose Reinsurance Vehicle Model Act (#789) had been developed to provide a uniform framework for the implementation of capital market securitizations of commercial insurers' reserves. Recognizing that securitization structures have evolved beyond those provided for in the model act, the Subgroup proposed that the NAIC re-evaluate the model act and update it as necessary to reflect alternative market solutions acceptable to state regulators so that the model act could serve its intended purpose of providing a uniform framework for the implementation of alternative market solutions. The Subgroup also suggested that the NAIC encourage states to adopt the model act and consider making the model act an accreditation standard in those states that have an active captive and SPV market.

3. **International Association of Insurance Supervisors ("IAIS") standards**

The draft White Paper expressed support for the IAIS Guidance Paper on the Regulation and Supervision of Captive Insurers, which takes the view that captives and SPVs that are owned by, or under common control with, insurers or reinsurers and are used for purposes other than self-insurance should be subject to a similar regulatory framework as commercial insurers.

4. **Credit for reinsurance**

The draft White Paper noted that captive or SPV reinsurance transactions involving conditional letters of credit or parental guarantees effectively permit the use of assets to support reinsurance recoverables, either as collateral or as capital, in forms that are otherwise inconsistent with requirements under the NAIC credit for reinsurance model law and regulation or other financial solvency requirements applicable to US-domiciled commercial assuming insurers. The consensus of the Subgroup was that those types of transactions are not consistent with the NAIC credit for reinsurance requirements and that redundant reserve concerns are more appropriately addressed through accounting for the underlying business at the primary insurer level, thereby eliminating the need for a separate reinsurance transaction. The Subgroup again expressed its support for the use of solutions designed to shift risk to the capital markets or provide alternative forms of business financing and reiterated its view that the NAIC should develop a uniform framework for the implementation of such alternative market solutions.

With respect to existing captive/SPV transactions, the Subgroup recommended enhanced disclosure in the statutory financial statements of ceding insurers regarding the impact of the transactions on the financial position of the ceding insurers. The Subgroup suggested that financial statement Note 10 M be enhanced to provide for disclosure of non-trade secret captive information and disclosure of the overall utilization of captives.

5. **Balance between confidentiality and transparency**

The topic of confidentiality versus transparency was the one on which the Subgroup achieved the least consensus. Some Subgroup members advocated for greater transparency of reinsurance transactions involving captives and SPVs. Other members recognized a valid basis for maintaining the confidentiality of certain commercial terms of captive and SPV transactions. Given that captives and SPVs owned by commercial insurers are typically utilized for a single transaction, those members pointed out that it would be relatively easy for competitors and other parties to learn the economics of the transactions from the disclosures in financial statements, which could cause harm to the ceding company and other parties to the transactions. Accordingly, in the draft White Paper, the Subgroup recommended that the NAIC Financial Condition (E) Committee study the issue of confidentiality related to commercially-owned captive and SPVs more closely. The Subgroup suggested that the study pursue greater clarity regarding the specific reasons for and against the use of confidentiality for captives and SPVs, as well as the types of information that

should and should not be held confidential, and that it seek to develop a framework that would provide greater uniformity in this area, possibly in the context of an updated framework for alternative market solutions as discussed in recommendation 2 above. The Subgroup also expressed the view that each state that has a domestic insurer in its holding company structure should be notified of a transaction of an affiliate that involves captives or SPVs, even if that state's domestic insurer is not a party to the transaction.

The 29 November 2012 meeting

At the 29 November 2012 meeting, the Subgroup reviewed comments received from both state insurance regulators and insurance industry participants regarding the 16 November 2012 draft of the White Paper. There was considerable debate, at times verging on the acrimonious, between commenters in the audience and members of the Subgroup, and in some cases even between members of the Subgroup. Speakers on the one side emphasized the concerns raised in the draft White Paper, while speakers on the other side pointed to the significant costs that would be imposed on life insurers if their ability to utilize captive and SPV financing structures were taken away. In conclusion, while the Subgroup indicated that certain clarifying changes would be made to the draft White Paper to address a number of the points raised in the comments, it does not appear that the basic thrust of the five recommendations discussed above will be significantly altered. The next step will be for the Subgroup to meet via teleconference to discuss a revised draft of the White Paper and, once a revised draft White Paper is approved by the Subgroup, it will then be forwarded to the NAIC Financial Condition (E) Committee for its consideration.

US – Reinsurance Task Force meeting highlights

On 1 December 2012, the Reinsurance (E) Task Force (**"RTF"**) met at the 2012 Fall National Meeting of the National Association of Insurance Commissioners held in Washington, DC.

Among the proposed 2013 charges for the RTF is the creation of the Reinsurance Financial Analysis (E) Working Group. This working group will support and assist the states in the review of reinsurance collateral reduction applications and will serve as a forum and coordinating group among the states on reinsurance issues relating to certified reinsurers that qualify for posting reduced collateral. It will support, encourage, promote and coordinate multi-state efforts with respect to certified reinsurers, including multi-state recognition of certified reinsurers. Among other things, this group will also provide advisory support with respect to issues related to determination of qualified jurisdictions from which certified reinsurers will be allowed.

Also with respect to reinsurance collateral reduction, the RTF released the draft "NAIC Process for Developing and Maintaining the List of Qualified Jurisdictions". The RTF has exposed this draft for a 45-day comments period. Among the points addressed in the draft are an expedited review of certain jurisdictions (Bermuda, Germany, Switzerland and the UK) to be identified as qualified jurisdictions such that reinsurers from those jurisdictions could become certified sooner.

In addition, the RTF considered various other aspects of the reinsurance collateral reduction issues, including the accreditation standard for reinsurance ceded that was adopted earlier this year and state reduced reinsurance collateral implementation efforts. Currently, 11 states have adopted revisions to credit for reinsurance statutes and/or regulations incorporating reduced reinsurance collateral requirements for non-US reinsurers from qualified jurisdictions based on the revisions to the Credit for Reinsurance Model Law (#785) and Regulation (#786). However, only Florida and New York have approved certified reinsurers for collateral reduction at this time.

The RTF also discussed Dodd-Frank's Nonadmitted and Reinsurance Reform Act (**"NRRA"**), including the RTF's survey of states regarding NRRA issues. An important concern of states is with respect to the NRRA's provisions that make a reinsurer subject to solvency regulation only by its domiciliary regulator. Under the NRRA, a reinsurer is an insurer "principally engaged in the business of reinsurance" and "does not conduct significant amounts of direct insurance as a percent of its net premiums". There remains uncertainty among states about how to treat, for instance, reinsurers that also have large segments of insurance business.

At the meeting, the RTF also considered updates on referrals from other NAIC groups, including referrals from: (a) the Statutory Accounting Principals (E) Working Group Regarding Reinsurance Transactions Involving Death, Disability or Retirement Reserves; (b) the Financial Analysis (E) Working Group Regarding Risk Transfer/Quota-Share Reinsurance Contracts; and (c) the Financial Condition (E) Committee Regarding Collection of Undisputed Reinsurance Recoverable Balances Held by Ceding Insurers in Receivership. Regarding (b), the RTF will be considering loss limitations or loss corridors in quota share reinsurance contracts; as an initial matter, the RTF staff is doing research on how frequently such features are used and by how many companies.

Finally, the RTF heard reports on international reinsurance issues as well as some other items.

Global – IAIS update

Consultation on policy measures for G-SIIs

On 17 October 2012, the International Association of Insurance Supervisors (**"IAIS"**) published a consultation on proposed policy measures for global systemically important insurers (**"G-SIIs"**), which are insurers whose distress or failure could cause significant disruption to the global financial system.

The proposed policy measures are divided into three categories:

- enhanced supervision: these measures are based on the IAIS' existing Insurance Core Principles, the Financial Stability Board's supervisory intensity and effectiveness recommendations and the IAIS common framework for the supervision of internationally active groups; special attention should be paid to group-wide supervision and each G-SII should develop a systemic risk reduction plan;

- effective resolution: this should involve consideration of the plans and steps needed to separate traditional insurance activities from non-traditional and non-insurance activities, the possible use of portfolio transfers and run-off arrangements in the resolution of entities conducting traditional insurance activities, and the existence of policyholder protection and guarantee schemes; and
- higher loss absorption capacity: this should reduce the probability of failure, so the IAIS proposes a cascading approach taking into account the extent to which the G-SII has demonstrated effective separation between traditional insurance activities and non-traditional or non-insurance activities.

It is expected that the first cohort of G-SIIs will be designated and made public in the first half of 2013. Measures on enhanced supervision and effective resolution are to be implemented immediately afterwards, with full implementation to be completed within 18 months of designation.

It is worth noting that the European Commission has also published a consultation on a possible recovery and resolution framework for non-bank financial institutions, which includes insurance and reinsurance firms.

The deadline for comments on the IAIS consultation is 16 December 2012 and the deadline for comments on the European Commission consultation is 28 December 2012.

Global Insurance Market Report

The IAIS has published its first Global Insurance Market Report, documenting the performance of primary insurers and reinsurers as well as key developments in the global insurance market. This report aims to give IAIS members and other interested parties a full and thorough understanding of the global insurance marketplace by providing an analysis of both publicly available and confidential data.

The report shows that insurers and reinsurers have been affected by the financial crisis and subsequent recession but that the industry has been resilient and there is evidence that insurers and reinsurers are now better capitalised than they were at the beginning of the crisis.

Although this first edition of the report is based on a comparatively small sample of 20 globally active insurers and reinsurers as well as confidential data collected from 48 large global reinsurers, the IAIS intends to increase the sample size for future editions of the report.

Further editions of the report are currently scheduled to be released on a biannual basis, starting in spring 2013.

Global – Global Federation of Insurance Associations established

On 9 October 2012, the Association of Mutual Insurers and Insurance Cooperatives in Europe announced the establishment of the Global Federation of Insurance Associations (**"GFIA"**) by 31 insurance associations representing 87% of worldwide insurance business.

According to a press release, the GFIA will be active in commenting on a broad range of issues affecting the international insurance industry, including developments in the systemic risk debate, the work of the IAIS in developing its common framework for the supervision of international groups, market conduct and trade issues, and initiatives relating to financial inclusion and anti-money laundering. The newly formed GFIA aims to give its members the ability to respond on a timely basis to international issues affecting the insurance industry and to speak with one voice.

GFIA includes among its members insurance associations from Australia, Bermuda, Brazil, Canada, Chile, Dublin, Europe, France, Germany, Italy, Japan, Korea, Poland, Portugal, Russia, South Africa, Spain, Switzerland, the Netherlands, the UK and the USA.

Hong Kong – Public consultation on key legislative amendments for establishment of independent insurance authority

On 26 October 2012, the Hong Kong government launched a three month public consultation on the key legislative amendments to the Insurance Companies Ordinance (Cap.41) for the establishment of an independent insurance authority (**"IIA"**). The IIA will replace the Office of the Commissioner of Insurance, a government department. The previous consultation exercise in respect of the proposed establishment of the IIA was launched in July 2010 and received a generally positive response from the public. The proposal for the establishment of the IIA is borne out of the government's desire to enhance consumer protection, facilitate the stable development of the insurance industry, and bring Hong Kong in line with the international practice of financial regulators being operationally and financially independent from government.

Key legislative amendments in the latest consultation document cover the following areas:

- the introduction of a licensing regime for insurance intermediaries, which will replace the existing self-regulatory regime – broad principles of conduct requirements will be laid down for insurance intermediaries;
- the regulatory powers of the IIA – the IIA is to be vested with new statutory powers for the effective regulation of authorised insurers and insurance intermediaries, including inspection, investigation, imposing disciplinary sanctions, suspension etc., and it may apply for court orders to compel compliance with inspection and investigation requirements;
- the exercise of the regulatory powers by the IIA – this is to be subject to checks and balances, with the government proposing to establish an Insurance Appeal Tribunal (chaired by a person qualified for appointment as a High Court Judge) to consider appeals against the regulatory (including disciplinary) decisions of the IIA; and
- the financing of the IIA – the IIA is to be self-financed with income streams from licence fees, service charges to insurers and licensees and a proposed levy of 0.1% on all insurance premiums.

Subject to views received on the legislative amendments set out in the consultation document, the government plans to introduce an Insurance Companies (Amendment) Bill in 2013, with a view to establishing the IIA in 2015.

Hong Kong – New outsourcing guidelines for insurers

The Office of the Commissioner of Insurance (**"OCI"**) recently published a Guidance Note on Outsourcing (**"GN14"**) to regulate the risks created by the outsourcing of business activities by insurers. As stated in the preamble to GN14, the outsourcing of business activities (including customer-related services and back-office activities) is becoming increasingly popular with insurers and, whilst such an arrangement may bring cost and other benefits, the view of the OCI is that it may also increase an insurer's risk profile and its dependence on other parties.

GN14 will come into operation on 1 January 2013. It applies to all insurers in Hong Kong, and covers the outsourcing of services to service providers, whether third parties (including group companies) or other business units of the same company, such as foreign branches and head offices. For insurers incorporated or based in Hong Kong, GN14 will apply to all outsourcing arrangements. For other insurers, GN14 will apply only to those outsourcing arrangements relating to their operations in Hong Kong.

Under GN14, insurers must notify the Insurance Authority before entering into a material outsourcing arrangement (or significantly varying an existing one) and provide the regulator with information and a detailed description in relation to the outsourcing arrangement in order to show proper compliance with GN14.

GN14 sets out the essential issues which an insurer should take into account in formulating and monitoring its outsourcing arrangements. These are:

- developing an outsourcing policy for approval by the Board;
- developing a materiality assessment framework;
- conducting a comprehensive risk assessment;
- exercising due diligence and care in selecting a service provider;
- undertaking outsourcing arrangements in the form of a legally binding legal agreement;
- ensuring that legal and statutory requirements regarding customer confidentiality are complied with;
- dedicating sufficient and appropriate resources to monitoring and controlling the outsourcing arrangements;
- putting in place contingency plans;
- being particularly vigilant in relation to overseas outsourcing (e.g. country risk); and
- controlling and monitoring the sub-contracting of outsourcing arrangements by service providers.

As regards transitional arrangements for insurers with ongoing material outsourcing arrangements (not expiring before 31 March 2013), they will be required to furnish the Insurance Authority with the information prescribed by GN14 within 30 days of the commencement date of 1 January 2013. All insurers should also conduct materiality and risk assessments on existing outsourcing arrangements within the first three months of 2013. If existing outsourcing arrangements do not comply with GN14, then insurers have until the end of 2013 to bring them into line.

Given that GN14 will come into force very soon, insurers should start making preparations to ensure compliance (e.g. by ensuring that appropriate policies are in place and staff are available and qualified to manage the outsourcing arrangements). As GN14 seeks to set out what is already perceived as international good practice, it may be that insurers will not have to make too many changes to their existing outsourcing arrangements; however, in light of the new supervisory approach of the Insurance Authority, it will be increasingly important for policies, processes and arrangements relating to outsourcing to be clearly documented.

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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