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2015 – what is on the horizon for the insurance industry?

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Overview

Across jurisdictions there are emerging trends for insurers and brokers. As expected most jurisdictions have witnessed an increase in the regulation of financial services but our horizon-scanning has found that regulatory focus is firmly on consumer protection and improved conduct across the European Union and also in Australia and South Africa. Both the work being undertaken by the International Association of Insurance Supervisors (IAIS) and Europe's Solvency II are driving much greater sophistication and risk-sensitivity in prudential supervision with the result that risk-based systems are gradually being introduced outside Europe – for example in Hong Kong.

Many common law jurisdictions have followed the early Australian example and reviewed the principles of insurance contract law to ensure they make local markets competitive in an ever global marketplace for insurance: the UK is about to rip-up the well-known principles of the Marine Insurance Act 1906 and South Africa is also reviewing provisions of its insurance laws. Similarly, we observe that jurisdictions such as Australia and China are taking steps to liberalise market participation by providing overseas insurers greater access to local markets in a move to boost competition.

New regulations are bringing market restructuring and consolidation, particularly in Europe where two major pieces of legislation, Solvency II and the revised Insurance Mediation Directive, will shake up the insurance industry. The revised regulation of intermediaries will bring greater scrutiny of conflicts of interest and commission arrangements with the result that distribution channels are likely to need to be reviewed over the coming year.

Collective redress or class action regimes are gradually being introduced in Europe following a recommendation for the introduction of such schemes by the European Commission. Both Italy and France have recently introduced collective actions and a tentative step has been taken to do similarly in the UK with the introduction of opt-out consumer competition actions under the Consumer Rights Bill.

What our review reveals is that in an increasingly globalised market regulators and litigators are looking at what other jurisdictions are doing with the result that leading markets are broadly taking a similar approach to supervising insurers. Greater consumer protection, greater risk-sensitivity in measuring capital and greater transparency are all emerging trends in the global market.

Australia

The Australian insurance market has received considerable attention in 2014, positively driven by the successful listing of health insurer Medibank Private in October and, on the other hand, the ongoing scrutiny of the life insurance market (particularly financial advisors). Against that backdrop, we expect the focus in Australia in 2015 to be on improving competition and market conduct rather than any significant reform to prudential regulation.

FSI report

The Financial Systems Inquiry final report (Murray Report), released on December 7, 2014, sets out the scope of reforms to the financial services market that will be considered by the Federal Government in 2015. Of the numerous recommendations, those potentially having an impact on the insurance market include:

- Conduct regulation: with an eye to regulatory developments in the UK and Europe, the Murray report recommends the introduction of a product design and distribution obligation on financial services providers, temporary product intervention powers where there is a significant risk of consumer detriment, better tools to measure insured values, increased powers to address commission and remuneration structures to align the interest of consumers with product providers and the introduction of higher training and competency standards for financial advisors.

- Market innovation: the Murray report recognises that competition and the success of the market will depend on encouraging innovation, and recommends government and industry co-operation, the removal of regulatory barriers to innovation (including more versatile product disclosure regulations), easier product rationalisation, increasing access to data, and reducing costs in respect of its use.

Prudential regulation

The Murray report generally reflects the common view that the Australian market withstood the global financial crisis because of sound prudential regulation. As such, save for recommendations aimed at improving the capital adequacy of the ‘Big Four’ banks, very little change is envisaged to the existing prudential regulatory regime.

However, in a surprising move by a regulator that has set high prudential requirements on market participants, the Australian Prudential Regulation Authority intends to relax licensing requirements to allow unauthorised foreign insurers to enter the home and contents insurance market in far north Queensland. The move is intended to address the lack of competition and affordability in that area caused predominantly by flood and wind risks. This may create significant opportunities for offshore insurers.

Access to Justice – Class actions

The Productivity Commission Report into Access to Justice Arrangements in Australia, released on December 3, contains both good and bad news for insurers. The recommendation that contingency fees be allowed for the first time may see an increase in unmeritorious claims. This is exacerbated by the recommendation that restrictions on lawyers’ advertising be abolished.

On a more positive note, the Commission also recommended greater regulation of litigation funders, including licensing, disclosure and conflict of interest obligations.

FOS terms of reference

New terms of reference will commence, with effect from January 1, 2015, for the Financial Ombudsman Service (FOS). Among other changes, the jurisdiction of FOS will expand to include small business interruption insurance claims, broking disputes (for claims lodged after January 1, 2016) and uninsured third party motor vehicle disputes.

Canada

- In 2015, the issue of the effects of new anti-corruption legislation – at the Federal and provincial levels – will most likely be of interest to many Canadian insurance professionals. For example, in Quebec, new claims will now be allowed to be brought by public entities against companies who may have used fraudulent or other dishonest manoeuvres to secure government contracts in the past. These new claims will be allowed against these companies and their directors, even if the statute of limitations has already lapsed. This could raise some interesting issues on the application of Directors and Officers (D&O) insurance coverage for these types of claims for former directors of these companies.

- The issue of liability insurance for the carriage of oil will also continue to be a major issue for the Canadian insurance industry in 2015. In the wake of calls for the relevant authorities to review and overhaul the regulatory regime governing the transport of oil and other hazardous and noxious substances by train, new requirements on third-party liability insurance needed for federally-regulated railway operators will soon be enacted by the Federal government. This could result in important changes in the liability insurance market in the coming years.

- Canadian insurers will also continue to monitor the increasing rigour imposed by the courts regarding the treatment of insureds' claims. Decisions by appellate courts in the last year have indeed sanctioned some insurers who have not acted in a forthright manner towards their insureds and have muddled the defence of their own interest with their duty to defend their insureds. Sanctions for this conduct can vary from the insureds being estopped from raising coverage arguments to punitive sanctions against insurers should bad faith in the handling of claims be proven.

- As was the case in 2014, reinsurers and market intermediaries in the Canadian market will continue to monitor the increasingly stringent requirements imposed by legislators regarding solvency, disclosure and implementation of equitable consumer protection measures, which includes the protection of personal information. In general, compliance with regulatory requirements is a growing sector of practice in the Canadian insurance market.

- Finally, the continuing growth of the specialised risk insurance sector, such as cyber insurance or contingency (or loss mitigation) insurance, will gather attention from an increasing amount of actors in the insurance field in 2015. These new products may become the focus of significant legal debates in the next few years, particularly as a large portion of insurance legislation in Canada has not yet been amended to reflect these new types of risk, which could lead to creative interpretations of 'traditional' insurance law by Canadian courts.

China

Although M&A transactions constantly occur in the insurance sector in China, it was only in 2014 that the Chinese insurance regulator (CIRC) formally issued regulations governing M&A activities. The regulations, which took effect on June 1, 2014, apply to M&A activities where an insurance company (either a domestic or a foreign invested insurer) is the target for a merger or acquisition.

The following points under the new regime are worth noting:

- With CIRC's approval, an investor involved in insurance M&A activities may borrow to finance such activities provided the amount borrowed does not exceed 50 per cent of the total monetary consideration. This substantially liberalises the existing legal regime under which investors are not allowed to use bank loans or other external funds to finance their investments in Chinese insurance companies.

- Subject to CIRC's approval, the acquirer for an acquisition will be permitted concurrently to control two insurance companies which engage in the same type of business. This is also a fundamental change to the existing regime, under which two or more insurance companies which are controlled by the same entity may not engage in the same type of insurance business if it could give rise to conflicts of interest or competition issues.

- Mergers remain subject to the current business separation rule, which is that an insurer should not engage simultaneously in life and non-life insurance business, though a non-life insurer may, subject to CIRC's approval, engage in short term health insurance and accident/injury insurance.

This new M&A regime provides a legal framework and also serves as guidance for insurers that are performing well to attract high quality capital and allow strong insurers to invest in weaker insurers.

European Union

Revised regulation of intermediaries

The renamed Insurance Distribution Directive (IDD), previously known as IMD2, is likely to be agreed by the European legislative bodies in the Spring of 2015. Transposition is expected within two years meaning that the revised rules for the distribution of insurance products may be in effect in early 2017. Broadly, the IDD introduces the following changes:

- Insurers selling direct to customers are brought within the scope of the regime. The IDD will apply to insurance intermediaries including aggregators and distributors that sell insurance products on an ancillary basis. The activity of 'introducing' is removed from the definition of insurance distribution.

- An overarching requirement for all distributors to 'act in the best interests of customers'. This imposes a high standard upon all distributors (including direct sellers and those distributing to professional customers) to consider the interests of customers in their business. Member States must introduce rules to ensure that distributors are not remunerated and do not remunerate or assess the performance of their employees in a way that conflicts with the duty to act in the best interests of customers, for example, sales targets.

- Disclosure and transparency. Before the conclusion of an insurance contract, intermediaries are required to provide details about themselves and must describe to their customer the nature of their remuneration (i.e. fee or commission, or other type of arrangement). The IDD excludes these obligations where the distribution relates to large risks, reinsurance or for 'professional customers'.

- Conflict management requirements for investment products. The IDD introduces higher standards of disclosure and conflict management for Insurance-based Investment Products (IBIPs). The European Commission is given powers under the IDD to introduce delegated acts in order to define the steps that distributors might reasonably take in order to identify, prevent, manage and disclose conflicts and to establish criteria for determining the types of conflicts that may damage the interests of customers or potential customers. Insurance distributors will also be subject to the requirement for packaged retail investment and insurance-based investment products (PRIIPs) to provide customers with a key information document (or KID).

- Enhanced professional standards. Those persons carrying out insurance distribution will be required to meet certain competency requirements and comply with obligations for continuing professional development, taking into account the nature of the products being sold and the type of distributor.

The current draft of the IDD also includes rules in relation to product governance and cross-selling. For example, manufacturers of insurance products must operate and review processes for the approval of each product before they are marketed to customers. The process should specify the target market and ensure that all relevant risks are identified. The IDD does allow cross-selling and bundling, however, distributors must inform customers whether different components can be bought separately. A description of each component and separate evidence of costs and charges must also be provided.

Once adopted, work will begin on developing the delegated acts in order for Member States to implement the new regime.

Countdown to Solvency II

The Solvency II transposition deadline of 31 March, 2015 is fast approaching. The Delegated Regulation which introduces much of the detail of Solvency II came into force on January 18, 2015 and has direct effect in all Member States.

The European Insurance and Occupational Pensions Authority (EIOPA) is in the process of consulting on guidelines and implementing technical standards which will ensure the uniform application of Solvency II. With much of the legislative detail and timetable now certain, national supervisory authorities are taking steps to ensure firms are prepared for the implementation date of January 1, 2016.

France

The key legal developments in 2015 for financial institutions in the French market reflect an increased focus on consumer protection, through new regulations and supervision, introduction of class action and new regulations on mandatory collective health insurance contracts for SMEs.

Life assurance: unclaimed contracts (disciplinary sanctions and new regulations), conduct of business and consumer protection

In 2014, the French Financial Supervision Authority (Autorité de Contrôle Prudentiel et de Résolution or ACPR) carried out an extensive control campaign on French life assurance companies, in order to assess their compliance with procedures for the search of beneficiaries of unclaimed life assurance contracts in line with the objectives of the French Insurance Code. In this context, the ACPR initiated disciplinary proceedings against some of the major players in the life sector, which resulted in significant pecuniary sanctions (ranging between €10-50m). Note that the maximum sanction that can be imposed by the ACPR amounts, in principle, to €100m. Further disciplinary decisions are expected in 2015.

On the same subject, a new regulation (Loi Eckert, Law n° 2014-617 dated June 13, 2014) has been adopted in order to raise the bar of the obligations of life assurance companies relating to the search and identification of the beneficiaries of life assurance contracts, the policyholders of which have passed away.

Stating that the existing regulations (dated December 2007) were rarely complied with in practice and thus afforded little protection, the new regulation strengthens the duties of insurers and requires, among other things, an annual check of their stock of life assurance and capital redemption contracts (without any minimum threshold as regards the amounts invested[1]), in order to determine whether the policyholder is still alive or has passed away and, in such cases, to initiate beneficiary search procedures. The publication of the stock of unclaimed contracts and related reports to be submitted to the ACPR will be required from insurers, as well as the revaluation of invested amounts and capping of applicable management fees (which may be deducted from the amounts invested under these unclaimed contracts). This new regulation started to apply in January 2015 and will be applicable in full from January 2016.

Before the new regulation was adopted, the ACPR issued a 'position', dated February 2014, stating that beneficiary search fees must remain at the insurance company's expense and may not be deducted from the amounts invested under the life assurance contract.

In January 2015, an ACPR recommendation (dated July 3, 2014) concerning the distribution of life assurance and capital redemption contracts and the associated marketing documents came into force.

The recommendation sets out detailed requirements on the obligations to be reflected in distribution agreements in order to clearly state the insurers' and intermediaries' respective roles and responsibilities in terms of: content of the marketing materials; and provision of reliable information to the insurance intermediary and to the end-customer on the main features of an insurance product. The distribution agreement must specify the documents containing information on the insurance product (notably as regards unit-linked contracts and the fees which are charged under the contract) and the minimum timeframe for transmission of such information, as well as storage and access conditions to such documents. This information must also be reflected in the distribution agreement in the case of a distribution chain of a life assurance/capital redemption contract (e.g. wholesale insurance broker and client-facing insurance broker, forming the distribution chain). The ACPR indicated in its recommendation that where an insurance undertaking or intermediary has failed to comply with the requirements, it must be in a position to explain the reasons for non-compliance.

1 Under previous regulation, the triggering threshold for the identification of beneficiaries was €2,000.

It seems likely that ACPR is planning controls or inspections in this area. Insurers, through their industry body Fédération Française des Sociétés d'Assurance, decided to lodge an annulment request before the French Administrative Supreme Court against this recommendation.

During a conference held late last year the ACPR emphasised that, in 2015, it will continue to place great importance on consumer protection issues in various areas of the insurance sector such as pre-contractual information, remuneration of the distribution chain, product governance and returns.

Litigation: introduction of class action by Loi Hamon

Loi Hamon (Law n° 2014-344 dated March 17, 2014) has created the class action 'à la française' known as 'action de groupe'. Loi Hamon has elected the 'opt-in' model and entitles only nationally representative and accredited consumer associations to represent consumers and bring a class action before the Courts (namely, the 'Tribunal de grande instance') in order to obtain compensation for individual economic losses (i.e. financial/material damages only) sustained by consumers in similar or identical situations.

Class actions are available in respect of sale of goods, provision of services and anticompetitive practices (excluding health and environmental law violations). Loi Hamon provides for two procedures: the 'regular procedure', which goes through three distinct phases (ruling on liability, opt-in phase and liquidation of the assessed losses) and the 'simplified procedure' (based on a 'closed' opt-in model).

This new regulation will impact the French litigation landscape. In the financial sector, a consumer protection association has already initiated a class action with respect to guaranteed returns in the context of a collective insurance agreement.

Mandatory collective health insurance for SMEs

'ANI' regulations (Loi relative à la sécurisation de l'emploi, Law n°203-504 dated June 14, 2013)

ANI introduces an obligation for all companies, regardless of the number of employees, to provide collective health insurance for the benefit of their employees from January 1, 2016. This new obligation applies to 4-5 million employees and potentially to 10 million persons in total (i.e. employees and their family). This presents a major opportunity for insurers and intermediaries to attract new clients and enter new markets. Second level legislation or professional negotiations will determine the scope and content of cover to be offered through these mandatory contracts.

French insurers and welfare institutions currently enter into partnership agreements in order to adapt their offer to the ANI regulations.

Germany

Consistency of the ‘policy model’ with European law

The Federal Court held on July 16, 2014 that a life insurance policy entered into under the ‘policy model’ (*policenmodell*) was consistent with European law. Until a statutory change in 2008, most life insurance policies were concluded under the policy model, i.e. the insurance policy was concluded with retroactive effect once the policyholder was provided with all necessary documents, properly informed about its right to withdraw from the life insurance policy within 30 days and did not withdraw from the policy within that period. The German Federal Court reasoned that the Second and Third Life Assurance Directive related, amongst others, to proper information prior to the conclusion of the life insurance policy, but did not contain requirements for the conclusion of an insurance policy. As a consequence, the requirements of policy conclusion were a matter of national law and did not require a decision of the European Court of Justice pursuant to the German Federal Court. This view, however, is not shared by considerable legal literature and by the German Constitutional Court.

In a second line of argument, the court reasoned that the issue of whether the policy model is inconsistent with European law was irrelevant to the decision as in the relevant case the properly informed policyholder had brought the claim only after the contract had been in force for several years. Thus the properly informed policyholder could not successfully claim repayment of the premium under unjust enrichment principles. This decision is likely to raise questions about whether contracts of insurance are considered to be concluded under an increasingly harmonised view of European consumer protection measures.

Life assurance: Life Insurance Reform Act

The 2015 German Life Insurance Reform Act (*Lebensversicherungsreformgesetz* – LVRG) aims at the long-term solvency of life assurers by responding to the current low interest environment. The new law further limits the right of exiting policyholders to participate in the valuation reserves. The reason is that while valuation reserves are currently relatively high and beneficial to exiting policyholders, the life assurers still need to finance the guaranteed interest rates for the remaining policyholders. To that end, the new law also introduces a prohibition on the distribution of dividends to shareholders to the extent that this would put the long-term financing of guaranteed interest rates at risk.

Further measures protecting policyholders are, for example: the reduction of the balance sheet acquisition costs (due to the reduction of the maximum zillmerization rate of 40 per thousand to 25 per thousand); decrease of the maximum guaranteed interest rate from 1.75 per cent to 1.25 per cent; and increase of the minimum stake in surplus participation to 90 per cent.

The new law also provides the Federal Financial Supervisory Authority (BaFin) with further supervisory rights and sets out requirements for the creation of comprehensive recovery plans.

Insurance distribution

The Life Insurance Reform Act has also had an effect on commission payments. This new law increases the transparency requirements for life assurance. Life assurers are now required to disclose to policyholders the entire administrative costs paid to insurance intermediaries. In addition, life assurers need to disclose to new policyholders the extent to which the rate of return of the policy is reduced by costs of the policy. As a response, many insurers are starting to review their commission payment structures.

While these amendments are currently only relevant for life assurance policies, it cannot be excluded that commission payments in other lines of insurance will be exposed to further pressure.

Warranty and indemnity insurance market

The trend for corporate sellers or buyers to take out warranty and indemnity insurance (W&I) for M&A transactions has increased significantly in the German market. While this product has in the past been used mainly by private equity buyers, it is now being more frequently used in transactions involving strategic buyers or for family owned business e.g. acquisitions made by the German *Mittelstand*.

Brokers market

While the German market for retail insurance business is still largely dominated by tied agents, commercial insurance, industrial and special risks have always been the domain of independent brokers. The broker market for the mid-market segment (i.e. SMEs) remains largely broken into smaller players. Given the increasing globalisation of the insurance sector and the proposals for the revised insurance mediation directive, greater consolidation of intermediary firms in the mid-market segment is to be expected over the next couple of years.

Run-off business

The requirements of Pillar I of Solvency II put certain lines of insurance businesses under strain, as does the low-interest environment and increasing regulatory requirements. Subject to general concern over the past few years, the run-off business for both life and non-life as well as particular group reinsurers is picking up. There are now a number of professional buyers established in the German market and it is expected that the run-off market will grow rapidly. The good experience insurers and reinsurers have had with existing run-off firms in the German market will help to make this a business that will assist firms to manage capital under Solvency II effectively in the non-life arena. As long as the transactions, whether portfolio transfers or acquisitions of risk carriers, are compliant with the respective rules, the German regulator BaFin appears happy to see run-off providers as an alternative to working out claims ‘in-house’.

Italy

Implementation of legislation allowing insurers to grant loans to entrepreneurs

The Competitiveness Decree of August 11, 2014 allows Italian insurance companies to grant financing directly to borrowers (other than individuals and micro-enterprises) for the purpose of widening the range of potential lenders and boosting access to credit. IVASS, the Italian insurance regulator, issued measures in October last year to implement the new legislation. Insurers shall adopt a ‘financing plan’, to be submitted to IVASS for evaluation, and are permitted to consider such financings as investments covering their technical provisions, up to certain thresholds which have been set by IVASS.

Insurers must be assisted by a bank or financial intermediary in the activity of selecting borrowers, and such bank or financial intermediary shall retain an interest in each transaction, until the expiration of the transaction (but such interest is transferable to other banks or financial intermediaries). Alternatively, insurers may seek an authorisation from IVASS to directly carry out the activity of selecting borrowers. Further implementation measures are expected to regulate access by insurers to the credit risk database kept by the Bank of Italy and periodic reporting to the Bank of Italy in respect of such financing business.

This development is consistent with wider efforts to encourage investment by insurers in the European economy.

Reform of the motor TPL policies

Motor third party liability (TPL) insurance, along with payment protection insurance (PPI), are the sectors in which legislators have focussed much of their attention in recent years with the aim of reducing costs to the consumer and, ultimately, boosting the Italian economy.

A new bill is expected to be enacted in the coming months introducing an option for insurers to offer potential policyholders a reduction in premium if they consent to prior inspection of the car or installation of a black box recorder. Furthermore, insurers will be able to require that vehicle repairs are carried out by their own network of repair services.

In addition, IVASS is expected to enact a further regulation, aimed at increasing competition, which introduces an obligation for insurance intermediaries to offer at least three quotes to the potential insured for the product required.

Implementation of new regulation concerning training of insurance intermediaries

As of January 1, 2015, insurance companies are expected to organise the training activities of their intermediaries and call centre staff using only technologies and trainers that satisfy the requirements set out in a regulation recently enacted by IVASS.

The regulation prescribes certain areas that should be part of the training, including technical, actuarial and economical aspects of insurance activities. Insurers will be required to review their training programmes to ensure compliance with the new regulation.

Implementation of new anti-money laundering provisions

Insurers are expected to adapt their systems and procedures on anti-money laundering, following the enactment of a regulation detailing customer due diligence obligations for the insurance market, which came into effect on January 1, 2015.

More regulations and inspections to come: aggregators, embedded products, PPI

Regulatory inspections and investigations have grown increasingly frequent since IVASS became a department of the Bank of Italy.

Following the enactment of two reports, the Italian regulator is expected to issue more specific regulations and increase the level of inspections in some key areas of the insurance market, such as:

- Online ‘aggregators’, or price comparison websites which have been criticised for failing to provide sufficiently clear and transparent information to consumers, for example, with regard to the range of insurers scrutinised.
- Insurance cover embedded or packaged with other products. Measures are expected to ensure compliance with the Consumer Rights Directive. IVASS is concerned that insureds might not be aware that they have purchased cover and that providers are not giving customers adequate information about costs.
- PPI. Regulatory action aims to ensure that the purchase of PPI by borrowers of mortgages and consumer credit loans is optional and policyholders are made aware of their contractual rights.

Tax focus on unit/index linked products

Following the implementation of the 'voluntary disclosure' legislation relating to assets illicitly held abroad by Italian tax pay-holders, there has been a material increase in the subscription of financial products issued by life insurers in the Italian market.

This development has sparked legislative interest in this type of business with the consequent introduction of a number of provisions aimed at aligning the tax treatment of life insurance policies to those other financial products. More burdensome legislation is therefore likely to be enacted in 2015.

United Kingdom

Insurance Act 2015 receives Royal Assent

The Insurance Act 2015 has received Royal Assent and will come into force in August 2016. The Act has followed a special Parliamentary procedure for uncontroversial Law Commission bills and marks the most significant change in insurance law in the UK for over a century.

The Act also includes a number of amendments to the Third Parties (Rights Against Insurers) Act 2010 which received Royal Assent five years ago but has yet to be brought into force. With amendments in the Insurance Act to address concerns with the statute, it is likely that the Third Parties (Rights Against Insurers) Act will finally come into force later in the year.

Making a fair presentation of a risk

The Act reforms the effect of the duty of utmost good faith on contracts of commercial insurance. The Act requires that insureds make a 'fair presentation of the risk' to insurers. This duty would replace the existing duty of disclosure and misrepresentation but will retain certain familiar obligations such as the requirement to disclose material information that the insured knows or ought to know. The Act will enable the insured to make a fair presentation where sufficient information has been disclosed to put a prudent insurer on notice that it must make further enquiries concerning the risk. The Act also requires that insureds ought to know what would be revealed through a reasonable search of information available to them.

Where an insured has deliberately or recklessly failed to make a fair presentation the insurer will be entitled to avoid the policy and must return premiums paid. In all other circumstances, remedies proportionate to the effect of the failure to present the risk fairly will be applied. For example, where the insured has failed to mention a particular fact the insurer may have a remedy to apply terms or conditions to the contract that they would have applied had the true position been presented to them. Similarly, where the insurer would have required a higher premium to cover the risk, a proportionate deduction will be made to any claims paid under the policy.

Warranties become 'suspensive conditions'

The Act changes the existing law in relation to warranties. Presently, where a warranty is broken by the insured, the insurer will automatically cease to have any further liability under the contract – the breach once made cannot be remedied. The Act enables a breach of warranty to be remedied where the remedy will have the effect that the risk continues to be as originally intended under the contact. The Act also abolishes 'basis of the contract' clauses in commercial agreements.

In addition, where a loss occurs the insurer will not be able to deny liability where a breach of a contractual term did not have the effect of increasing the risk of the loss that actually occurred. In other words, it will no longer be possible for an insurer to deny liability for a burglary claim where the insured did not have a working sprinkler system.

Insurers' remedies for fraudulent claims
The Act also introduces remedies where the insured has made a fraudulent claim. Where fraud is committed by the insured, the insurer will not be liable to pay the claim to which the fraud relates. Any money already paid out for that claim may be recovered by the insurer. The insurer will remain liable for claims made in relation to events that take place prior to the specific fraudulent act. Once the insurer has elected to treat the contract as terminated it can refuse to pay claims relating to 'relevant events' (i.e. notice of claim or potential claim) that take place after the fraud.

Opting out
For commercial insurance the changes introduced are a default regime. If insurers propose to alter the default regime with any term which would have a more disadvantageous impact on the insured, the term must be sufficiently drawn to their notice. It will not be possible to contract out of the law concerning basis clauses, which are now effectively outlawed in either commercial or consumer contracts.

Next steps
Insurers will now need to start preparing revised policy terms which take the Act into account. Furthermore, the change in obligations in relation to what information is deemed to be known to an insurer may require a review of internal processes to ensure that it is clear what types of information will be taken to be known by underwriters. Underwriters must now make further enquiries where they are provided with information that should put them on notice that things may not be quite as described.

Brokers should also consider their obligations under the Act and should ensure that they are prepared to provide information in a manner which will make a fair presentation of the risk to underwriters. It will no longer be possible to disclose everything in order to discharge the duty of good faith. The quality of the information and its presentation to the underwriters will be crucial.

Clearly, there are some things that insurers and brokers cannot prepare for. The new law will be an unknown judicial territory. Although much criticised, the current law is at least familiar to the industry and to judges alike. New law brings new uncertainties, even if the change is overall a positive one.

Focus on tax to continue for insurers

UK insurers are likely to find themselves under increasing tax focus, with insurance premium taxes an increasingly important source of tax revenue, and tax authorities looking ever more closely at group and offshore arrangements.

On this theme the UK Government, in December 2014, unveiled new legislation to counteract tax planning arrangements used by some multi-national groups to avoid paying tax in the countries where they make most of their sales. The legislation proposes a Diverted Profits Tax which will levy tax on profits diverted from the UK at a rate of 25 per cent.

While insurance groups were not the primary focus of the measures, it is clear that they would be affected by the proposals, as they stand at the moment. Since they were first announced, there have been intensive discussions on their scope. It is clear that the new tax will be introduced, but the industry is looking for confirmation that generally insurance groups are not be caught, provided group companies based in low-tax jurisdictions have sufficient substance – although as ever, that is hard to measure.

Hong Kong

Overhaul of insurance regulatory framework

The Hong Kong insurance regulatory framework is expected to undergo significant change in 2015 through the enactment of the Insurance Companies (Amendment) Bill 2014, including the establishment of an Independent Insurance Authority (IIA) to replace the existing Office of the Commissioner of Insurance/Insurance Authority (OCI).

The Bill was published in April 2014 following several years of preparation and consultation. The changes to be introduced by the Bill will affect insurers and insurance intermediaries. It is anticipated that the new regime will come into effect this year with phased transitional periods in respect of certain provisions. For example, insurance intermediaries holding existing registrations through self-regulatory organisations will be deemed licensees under the new regime for three years following its introduction.

Key changes proposed under the Bill include:

- The establishment of the IIA which will perform the functions currently performed by the OCI and will otherwise replace the existing self-regulatory system. The IIA will be vested with appropriate powers of inspection and investigation and will be empowered to impose disciplinary sanctions on insurers and insurance intermediaries. In addition to the IIA, an Insurance Appeals Tribunal will be established to review the IIA's decisions.

- The introduction of a statutory (as opposed to self-regulatory) licensing regime for insurance intermediaries and enhanced conduct regulation through primary legislation – including the introduction of a requirement for intermediaries to appoint Responsible Officers subject to IIA pre-approval. Details will be included in subsidiary legislation and non-statutory codes and guidelines.

- The introduction of statutory requirements to enhance the internal corporate governance procedures and conduct of insurers and insurance agents.

- The scope of carrying on 'a class of insurance business' is clarified under the Bill. A definition of 'regulated activities' is proposed similar to the Hong Kong securities legislation and this will include activities of intermediaries as well as insurers within its scope.

Proposed introduction of risk-based capital regime

In line with the IAIS Insurance Core Principles 16 (enterprise risk management for solvency purposes) and 17 (capital adequacy), the OCI proposes to introduce a risk-based capital (RBC) framework for insurers. The existing Hong Kong capital adequacy framework is rules-based. In this regard, a public consultation on the proposed framework closed in mid-December.

The RBC regime foresees three pillars:

- quantitative requirements – including capital adequacy assessment and valuation
- qualitative requirements – including corporate governance, enterprise risk management and own risk and solvency assessment
- public disclosure and transparency regarding insurers' capital.

These pillars will likely be familiar to international insurers who have already invested in preparing for Solvency II in the European Union, but it should be noted that details of the Hong Kong RBC framework yet to be worked out include how:

- group-wide supervision will work in practice, including how foreign insurers authorised in Hong Kong as branches will be treated
- captives will be dealt with
- foreign RBC decisions by the OCI (including requiring add-ons or more capital) can be challenged.

What's next? It is expected that further detailed rules will be developed and quantitative impact studies undertaken and that the new law on the RBC framework will be proposed in 2015 and 2016, with a phased implementation in 2016 and 2017.

Contracts (Rights of Third Parties) Ordinance – for whose benefit?

The Contracts (Rights of Third Parties) Ordinance was gazetted on December 5, 2014. The Ordinance reforms the Hong Kong law on privity of contract and closely follows the UK Contracts (Rights of Third Parties) Act 1999. The Ordinance will permit a third party to enforce a contractual term if the term purports to confer a benefit on the third party or if the contract expressly provides that the third party may enforce under it. Its commencement date has not yet been announced and the Ordinance will not apply to contracts entered into before its commencement.

The effect of the Ordinance in the insurance sector is not yet entirely clear given that there is an existing Third Parties (Rights Against Insurers) Ordinance under which a third party may have a direct cause of action against an insurer in certain 'specified circumstances'. These circumstances include where an insured becomes bankrupt or enters into an arrangement with his creditors. In such cases the insured's rights against the insurer under the policy transfers to the third party to which the insured is primarily liable. It is anticipated, however, that the enactment of the Contracts (Rights of Third Parties) Ordinance will lead to increased claims by third parties to enforce policies. Insurers should consider their policy wordings and other contractual arrangements as it is possible to expressly contract out of the Ordinance.

Singapore

In 2014, the Monetary Authority of Singapore (MAS) published two consultation papers covering:

- outsourcing for financial institutions
- policy proposals under the Financial Advisory Industry Review (FAIR).

In September 2014, MAS issued two consultations on their proposals for outsourcing: (P018-2014 Notice on Outsourcing and P019-2014 Guidance on Outsourcing). The proposed Notice and Guidelines will affect all financial institutions licensed by MAS who outsource or contract out any of their business processes to any party (whether third parties or related parties). Financial institutions are anticipating these measures to be implemented during 2015.

Two specific proposals in the outsourcing consultation papers will (if implemented) have significant practical consequences with notable time and costs needed for compliance. These are:

- The requirement to obtain legal advice concerning the confidentiality provisions of the jurisdiction in which an overseas outsourced service is to be performed (in particular in relation to whether customer information might need to be disclosed by law).

- The requirement to provide a written confirmation from the supervisory authority of an overseas outsourced service provider that it will not access customer data and will only access information with prior notification to MAS with an undertaking to safeguard the confidentiality of any such customer information.

In October 2014, MAS issued a consultation paper proposing legislative amendments to bring into effect proposals under the Financial Advisory Industry Review (FAIR), covering five core concerns:

- raising the competence of financial advisor (FA) representatives
- raising the quality of FA firms
- making financial advising a dedicated service
- lowering distribution costs by enhancing market efficiency
- promoting a culture of fair dealing.

The proposed amendments will have the greatest impact on life insurers and general insurance brokers (who are exempt from holding a separate FA license under the Financial Advisors Act but subject to its provisions) as well as life insurance brokers (licensed under the Financial Advisors Act). MAS aims to implement the full suite of FAIR initiatives in 2015.

South Africa

The Insurance Laws Amendment Bill which sought to address shortcomings in both the Long Term and Short Term Insurance Acts of 1998 lapsed and was withdrawn from parliament. The regulators therefore intend to achieve the aims of the bill through other forms of regulation, likely to be considered over the course of 2015.

The Treating Customers Fairly (TCF) programme has now been implemented. It forms the underlying basis for the insurance regulator's approach to regulation, which is becoming increasingly consumer-centric.

The Financial Services Board (FSB) published its Retail Distribution Review (RDR) in November 2014. The RDR is open for comment until March 2, 2015. The review has been heavily informed by the TCF framework. The RDR will mean a more proactive and interventionist approach to regulation. The paper proposes regulation of market conduct to deal with the risks inherent in the current distribution landscape. An activity-based approach to defining advice, intermediary services and other services provided by advisers and intermediaries is proposed.

The RDR focuses on advice. Three forms of advice are defined, namely financial planning, upfront product advice and ongoing product advice. Standards will be set for ongoing product service. Insurance premium collection will be limited to qualifying intermediaries only. Standards will be set for referrals and lead generation. Three types of financial adviser are to be defined, namely independent financial advisers, multi-tied advisers and tied advisors. Standards will be set regarding a product supplier's responsibility for the conduct of tied advisers, multi-tied advisers and independent financial advisers.

Proposals relating to intermediary remuneration are also invited and all remuneration will have to be reasonable and commensurate with the actual services performed. Caps on various fees will be investigated. All fees paid by customers must be motivated, disclosed and explicitly agreed to by the customer.

A lot of the content of the RDR paper still needs to be further investigated, consulted on and fleshed out. The changes will be implemented in a phased manner. It is not expected to be implemented before mid-2016. There is likely to be an implementation period of approximately 12 months.

United States

Relief after Senate passes Terrorism Risk Insurance Act in a last minute vote before existing legislation lapses

The United States Senate has granted approval for the renewal of the Terrorism Risk Insurance Act or TRIA as it is commonly known. TRIA was passed in 2002 following the September 11 attacks in order to ensure that terrorism cover was available. Essentially it provides a government back-stop reinsurance coverage which will attach after a deductible has been paid. In order to pass through legislation TRIA has been adapted with the result that the amount of deductible will be gradually increased from $100m to $200m – an increase that will take place through an annual increase of $20m for five years from 2016.

The approval of TRIA will be welcome news for many US property and casualty insurers who, without this backstop reinsurance coverage, might have had to cease offering cover for terrorism losses. There will be relief not just from the insurance industry but also the US public. There had been concerns that without guaranteed terrorism cover, the 2015 Super Bowl might not have been able to go ahead.

Deepwater Horizon redefines the scope of additional insured coverage under Texas law

On February 13, 2015, the Texas Supreme Court handed down its decision in the closely-watched *In re Deepwater Horizon*, No. 13-0670 (Tex. 2014) case. The case arose out of the massive damages caused by the 2010 offshore well blowout in the Gulf of Mexico involving British Petroleum (BP) and its drilling contractor, Transocean. The issue was whether British Petroleum (BP) was entitled to $750 million in insurance proceeds as an additional insured under Transocean's liability policy. The answer was 'no'.

The additional insured provision in Transocean's policies extended coverage to '[a]ny person or entity to whom the 'Insured' is obliged by oral or written 'Insured Contract'... to provide insurance such as afforded by [the] Policy.' The policies further defined 'Insured Contract' as 'any written or oral contract or agreement entered into by the 'Insured'... and pertaining to business under which the 'Insured' assumes the tort liability of another party to pay for

'Bodily Injury' [or] 'Property Damage'... to a 'Third Party' or organisation'. The drilling contract at issue also contained an insurance provision under which Transocean agreed to name BP 'as additional insureds in each of [Transocean's] policies, except Worker's Compensation for liabilities assumed by [Transocean] under the terms of [the drilling contract]'.

The parties did not dispute that BP agreed in the drilling contract to be responsible for all subsurface pollution while Transocean agreed to assume liability for all above-surface pollution. The blowout and ensuing oil spill occurred below the surface of the water.

BP sought coverage, arguing that the scope of its coverage under Transocean's policies as additional insured could be determined only by the four corners of Transocean's policies. More specifically, BP argued that: (1) the drilling contract was an 'Insured Contract'; (2) the drilling contract obligated Transocean to provide additional-insured coverage; (3) BP was therefore an additional insured under the additional insured provision in Transocean's policies; (4) there were no limitations on the scope of coverage in Transocean's policies; and (5) BP therefore was covered for all liabilities (including subsurface pollution liabilities) in connection with the well at issue under Transocean's policies.

In response, Transocean and its insurers argued that Transocean's policies incorporated the drilling contract by reference and thereby limited the scope of BP's coverage to only those liabilities Transocean agreed to assume in the drilling contract, i.e., above-surface pollution liabilities.

The Supreme Court of Texas held for Transocean and its insurers. The Court first noted that Texas cases, including *Evanston Insurance Co. v. ATOFINA Petrochemicals, Inc.*, 256 S.W.3d 660 (Tex. 2008), require courts to consider the terms of an underlying 'Insured Contract' to the extent the policy language directs courts to do so. The Court then opined that, because BP's status as an additional insured was predicated on the drilling contract, the scope of BP's coverage under Transocean's policies required reference to the drilling contract's insurance provisions. Relying on the drilling contract's requirement that Transocean only add BP as an additional insured 'for liabilities assumed by [Transocean] under the terms of [the drilling contract]', the Court then held that the additional insured provision only extended coverage to BP for the above-surface liabilities assumed by Transocean in the drilling contract. Because the liability here was related to subsurface pollution and Transocean only agreed to assume liabilities for above-surface pollution, the Court held that BP was not an additional insured for the *Deepwater Horizon* claim.

This holding is intriguing, because while the Court quite logically notes that courts must consider the terms of an underlying 'Insured Contract' to the extent the policy language directs courts to do so, the Court did not explain at length how Transocean's policies directed the Court to consider the terms of the drilling contract in relation to limitations on the scope of coverage.

While it is clear that Transocean's policies directed the Court to consider the drilling contract to determine whether BP was an additional insured by virtue of being an 'entity to whom [Transocean was] obliged by oral or written 'Insured Contract'... to provide insurance such as afforded by Transocean's Policy,' Transocean's policies did not explicitly state that the coverage afforded under the additional insured provision was limited in scope such that it matched the scope of Transocean's obligation to procure insurance for BP as stated in the drilling contract. Instead of relying on an explicit textual 'hook', the Court relied on the interrelated nature of Transocean's policies and the drilling contract to find that a limitation on the scope of coverage Transocean agreed to provide to BP in the drilling contract necessarily limited coverage under Transocean's policies.

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