

2010 – the regulatory outlook for the insurance sector – an expert view

Insurers and brokers face huge challenges in dealing with the tougher regulatory environment of 2010. At CMS we are deeply involved in these changes and our experts are frequently quoted by leading commentators and the national press; you can view our quoted views in our RegZone library.

In this overview, we summarise the outlook for regulation in the insurance sector and our views on the likely impact of these changes. If you are interested in hearing more detailed analysis in any of these areas – please contact us to arrange a presentation or discussion. In the meanwhile, you can visit our RegZone at www.law-now.com/regzone to see our online materials to help insurers and brokers deal with the fast changing world of regulation.

FSA's says that the whole sustainability of the insurance sector faces a challenge from the combined effects of regulatory/legislative changes and the macro-economic climate. Its other key risk messages for the sector focus on

- Consumer product design and distribution,
- Assessment of the post crisis environment on risk and the changes required to underwriting and reserving/ pricing,
- The need to focus on preparations for Solvency II including internal model approval and QIS 5.

Increased regulatory exposure for firms and individuals

Individuals - personal exposure and risk in the new regulatory order – the UK (unlike other European countries) has a highly developed system for regulating individuals within financial institutions. In 2010, FSA will make much greater use of this lever, increasing personal responsibility and the exposure of executive and non-executive directors and senior managers. When a firm is under scrutiny for front-line breaches, it will be standard practice to conduct a parallel investigation of key board members to determine if they have breached FSA's rules for individuals. This will depend on whether they can show that they have met FSA's new standards for governance and controls. Otherwise they will face personal sanctions, including recently increased fines for individuals.

We have analysed the risks in the new tougher enforcement regime and prepared training on how to protect you as an FSA approved person. We can provide legal assurance on mitigating individual exposure based on our handling of many cases defending directors and senior managers before FSA.

In-house counsel and board briefing on regulatory engagement - are you ready for the new world of regulation in 2010?

There is a bewildering range of new rules and regulation in the pipeline. In 2010 FSA aims to intensify supervision, which will be more challenging and intrusive. FSA will now make 'judgements on judgements' – which may involve challenging a firm's business model, structure, strategy and products.

We can provide an exposure health check to ensure you are aware of and prepared for all the key areas of change and FSA focus.

Firms - more challenging supervision - including more intrusive Arrow visits - and tougher enforcement. FSA will roll out its tougher supervisory and enforcement regime in 2010. It will take a much harder line on Arrow visits, thematic reviews and when problems arise. It is much more ready to appoint external investigators (under section 166) and move firms into enforcement without giving them the chance to remedy breaches. Fines will be much higher and compensation/redress will increase.

We have a walk through process to review enforcement risk. We offer a tried and tested process for preparing insurers, brokers and their directors for Arrow visits including mock interviews based on broad experience of FSA interviews and Arrow visits. On the Regzone, you will find detailed guidance on 'handling a regulatory crisis' – to help with your contingency planning and when a crisis occurs. We can provide legal assurance on all aspects of exposure from the new supervisory and enforcement regimes.

Tougher insurance regulation as post crisis reforms spill over from the banking sector

Governance under the spotlight – there is huge drive (domestically and internationally) to introduce tougher governance requirements as a mechanism to prevent excessive risk taking. Although the original post crisis concerns focused on banks, these new rules will apply to the insurance sector. FSA is increasing the different ‘internal policeman’ roles and the specific responsibilities of each executive and non-executive officer for governance and controls. The domestic agenda will be re-enforced by the new Solvency II requirements for 2012.

We can provide a comprehensive view of the many different requirements emerging from FSA, Walker and Europe and benchmark your governance structure and the changes required. We can also provide NED and director training on the new regulatory environment. We can review ERM structures under both domestic and the new EU requirements.

Institutional reform - the new regulatory institutions and powers – the debate on ‘more Europe’ or ‘less Europe’ will continue in 2010 with the introduction of the new European System of Financial Supervision and the new EIOPA for insurance. These changes fall short of the ABI’s proposals for a single EU supervisory body but they will still have a significant impact on cross border insurance businesses and groups.

We assist insurers in understanding the changes and help them prepare for the new regime at a strategic and compliance level. This includes new group level supervision under Solvency II.

The threat to insurers from the new regime – the coalition government’s decision to move to twin peaks regulation – abolishing the FSA – will impact on the insurance industry. From 2012 insurers will be prudentially regulated by the new Prudential Regulatory Authority (PRA); conduct of business and markets regulation will fall to the new Consumer Protection and Markets Authority (CPMA). It is vital that the insurance industry plays full part in the forthcoming consultation on the new regime, particularly as institutional reform has been driven by the need to resolve problems in the banking sector and with little regard to the merits so far as the insurance industry is concerned.

We provide analysis and briefings on the new regime and the impact of post crisis reform on the insurance sector. We can assist in lobbying, consultation responses and strategic planning.

Insurers – structuring to achieve capital and tax efficiency in Europe

Group re-organisations in preparation for Solvency II . Many groups are considering how to achieve the optimum group structure – in terms of capital, tax and regulation – for their EU operations, particularly under the new Solvency II rules, which take effect in 2012.

We provide strategic advice on re-structuring to achieve efficiency, and assist in the planning of re-organisations. We provide transactional support such as carrying out major portfolio transfer projects (Part VII transfers in the UK) under EU rules. Assignments (which may also be capital driven) include transfers of non-core books of business and legacy long tail portfolios and a variety of exit solutions. We work closely with CMS offices across Europe. We also provide post-transaction services for new group structures and for new business integration. We handle major projects addressing issues such as the legal and compliance risks.

Solvency II for lawyers – 2010 will see yet more vast amounts of material from the numerous bodies involved in completing the detailed rules for the new solvency II regime. In-house counsel at insurers and life offices may find it very difficult to gauge how much they need to know and in what areas. Some may not grasp the basic principles of financial regulation or the impact on governance, ERM and more specific reforms in areas such as legal risk. Solvency II also provides the likely mechanism for requirements on remuneration governance.

We provide training on Solvency II directed at in-house counsel, focusing on key messages in the areas relevant to the legal and compliance departments.

Life and personal lines – the threat from even greater consumer protection

A tougher regime for the life and personal lines market – There will be even tighter control of sales and a new willingness to regulate consumer products themselves. This will extend current TCF and unfair contract terms regulation. Firms will face much earlier intervention to close down products or sales triggering significant FOS complaints.

We provide analysis of how these changes will impact personal lines products and distribution. We advise insurance firms on how to protect themselves against FOS compensation awards (particularly the wider implication risks) and requirements to withdraw products/distribution.

RDR – preparing for the new market – FSA is planning a major shake-up in the UK retail investment market (and the EU is also considering legislation). The new RDR regime will take effect in 2012. There will be major impacts on product providers, advised distribution channels and advisor intermediaries. Commission based remuneration for will be banned – forcing competitive fee negotiations between advisor and client. Independent status will be more demanding with other advised channels being labelled 'restricted advice'. Higher qualification requirements will force many individuals out of advised sales, which poses a major challenge for many firms and distribution channels.

We provide strategic advice and analysis on the new regimes and assist in new distribution structures. As we move towards 2012, we can support RDR projects to ensure firms are fully prepared including detailed compliance advice on exactly what is and is not possible under the new rules.

The new market for loan protection – 2010 will see the next stage of the long-running PPI story. **Past sales** - FSA will increase pressure on firms in the context of their handling of the very large volume of complaints and the risk of enforcement action is high. **The new regime for future business** - the Competition Commission will reach its final (post-appeal) decision on the ban on PPI sales at the credit point of sale; the market has already moved on, prompting FSA concerns about a broader range of products used for loan protection. Firms will need to develop products, distribution and sales processes that meet the combined requirements of both FSA and the Competition Commission.

We have been involved with different aspects of the PPI saga – giving both enforcement/complaints handling advice and advisory work on the new regime. We provide insurers with expert analysis and work on the design of new products.

Brokers- spotlight on client money after the Lehman Brothers debacle

In the wake of the collapse of Lehman Brothers, FSA has turned a sharp spotlight on client money and client asset protection in a bid to address the glaring failings in the CASS regime and issues in firms' implementation of CASS.

We have been heavily involved in FSA's series of CASS reforms/proposals post Lehman, including providing advice to brokers following FSA's recent "Dear CEO Letter" on client money issues which are commonly arising out of firms' audit processes.

FSA's message on CASS is clear - compliance is poor across the whole of the financial services industry and is now an urgent and key priority for FSA's Enforcement team. Firms need to take action now to address failings and in order to provide CEO sign-off that their firm is CASS compliant, as FSA has required.

In the meantime, FSA has also put up for consultation the first in a series of proposals beefing up the CASS Rulebook. These will include in Q1 of 2011 FSA's proposals for overhauling CASS 5 which are likely to have a significant price tag for insurance brokers. The first consultation includes policies to enhance client protection in the event of a firm's failure, such as restrictions on the amount of client money that can be held with group entities. It also seeks to establish clearer governance arrangements by proposing a new significant influence function - the creation of a Client Assets Oversight Function. This will require each insurance broker to have a single person with oversight and responsibility for client assets and money. Finally FSA has proposed to re-introduce a client money and assets return (CMAR) requiring brokers to report on client asset positions.

Drawing on our work in this area, we can provide you with an urgent healthcheck to identify important issues and ensure you are CASS compliant as well as offering expert help and guidance in preparing for the latest reforms.

Other topics

We also offer analysis, training and legal assurance in other areas, including –

- Compliance for insurers and brokers under the new Bribery Act regime – including the current concerns about the impact on standard industry practices
- Sanctions rules for underwriters
- Conflicts and broker remuneration
- Changing competition law risks for insurers - the BIPAR principles and the new EU block exemption
- Reform of the OTC derivative markets

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