

Financial Markets Law Committee (“FMLC”)

Insurance Scoping Forum

Date: Thursday 7 December 2017

Time: 10.00am to 11.30am

Location: Bank of England, Threadneedle Street, London, EC2R 8AH



In Attendance:

| | |
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| Peter Spires (Chair) | Lloyd's of London |
| George Belcher | Skadden, Arps, Slate, Meagher & Flom (U.K.) LLP |
| Nick Bonsall | Slaughter and May |
| Nicholas Bugler | Willkie Farr & Gallagher (U.K.) LLP |
| Theresa Chew | Hymans Robertson LLP |
| Katherine Coates | Clifford Chance LLP |
| Pollyanna Deane | Simmons & Simmons LLP |
| Beth Dobson | Slaughter and May |
| Reid Feldman (dial in) | Kramer Levin Naftalis & Frankel LLP |
| Matthew Griffith | RPC |
| Adrian Hacking | Scor SE |
| David Kendall | Cooley (U.K.) LLP |
| Geoffrey Maddock | Herbert Smith Freehills LLP |
| Alison Matthews | Herbert Smith Freehills LLP |
| Steven McEwan | Hogan Lovells International LLP |
| James Middleton | AIG Europe Limited |
| Selina Sagayam | Gibson Dunn & Crutcher LLP |
| Chris Sage | Transatlantic Reinsurance Company |
| Victoria Sander | Linklaters LLP |
| James Smethurst | Freshfields Bruckhaus Deringer LLP |
| Clare Swirski | Debevoise & Plimpton LLP |
| Kees van der Klugt | Lloyd's Market Association |
| Michael Wainwright | Dentons UKMEA LLP |
| Graham White | Marine Aviation & General (London) Ltd |
| Venessa Parekh | FMLC |
| Thomas Willett | FMLC |

Registered Charity Number: 1164902.

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Regrets:

| | |
|------------------|--|
| Jennifer Donohue | |
| Hilary Evenett | Clifford Chance LLP |
| Richard Farnhill | Allen & Overy LLP |
| Charlotte Heiss | Royal & Sun Alliance Insurance Group plc |
| Adam Levitt | Ashurst LLP |
| Sean McGovern | XL Catlin |
| Mike Munro | CMS Cameron McKenna Nabarro Olswang LLP |
| Chris Newby | AIG Europe Limited |
| Cary Rudolph | Marine Aviation & General (London) Ltd |

Minutes:

1. Introduction.

1.1. Peter Spires opened the meeting and delivered a brief introduction.

2. Administration:

a. a short presentation: Your Scoping Forum Needs You (Venessa Parekh);¹

2.1. Venessa Parekh described to the participants what their role as a member of an FMLC Scoping Forum involves, specifically outlining the roles of the Chair, Speakers and Forum Members before, during and after the Forum meetings.

b. confirmation of the draft 2018 Forward Schedule;²

2.2. As no concerns were raised, the dates for the 2018 Forward Schedule are now confirmed.

c. suggestions for the 2018 Forward Agenda.

2.3. No suggestions for the 2018 Forward Agenda were raised during the meeting. The Secretariat very much welcomes any agenda topic or speaker suggestions for the meetings in 2018.³

¹ Please see Appendix I below.

² *Ibid*, slide 6.

³ If you have any suggestions for the 2018 Forward Agenda, please contact Thomas Willett at forums@fmlc.org.

3. PRA and FCA regulatory framework for insurance special purpose vehicles (Katherine Coates)

- 3.1. Katherine Coates delivered to the Forum members a talk on the regulatory framework for insurance special purpose vehicles (“**ISPVs**”). ISPVs are designed to facilitate the transfer of risk from a (re)insurer to the capital markets via the issuance of insurance-linked securities.
- 3.2. Ms Coates began by citing the 2016 consultation paper released by HM Treasury on the regulations implementing a new regulatory and tax framework for insurance linked securities (“**ILS**”).⁴ This paper sought feedback from the market to ensure that the regulatory approaches to ILS are suitable for the market requirements and was responded to in depth by the ILS Taskforce, set up by the London Market Group of which Ms. Coates was a member.
- 3.3. Ms Coates then relayed the satisfaction of the taskforce with the final regulations, emphasising how it covered three key areas: (i) taxation regulation; (ii) the framework for the regulatory structure in the Financial Services and Markets (Risk Transformation) Regulations (2017/1212) (the “**risk transformation regulation**”); and (iii) also in those regulations, a new corporate structure for multi-arrangement ISPVs.
- 3.4. Turning to the taxation regulation, Ms Coates highlighted the success achieved by the approach adopted, with a simple regulation that is widely considered to be fit for purpose. The bespoke taxation regime for ILS in the U.K. will involve: (i) exempting ISPVs from corporation tax on their insurance risk transformation; (ii) a complete withholding tax exemption on distributions from the ISPV to investors; and (iii) U.K. investors being taxed on distributions as normal according to their facts and circumstance.
- 3.5. With regards to the new corporate structure, Ms Coates explained how the government has, in common with other countries, approached the corporate structure for multi-use ISPVs, which take on multiple contacts for risk transfer by creating a protected cell company (“**PCC**”). The PCC regime is designed to meet Solvency II requirements through the segregation of risk transfer contacts. A PCC will also be a company limited by shares, and will consist of the core and any number of cells needed to manage the ILS

⁴ HM Treasury, *Regulations implementing a new regulatory and tax framework for Insurance Linked Securities*, (November 2016), available at: https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/571091/Insurance_Linked_Securities_final_web.pdf.

deals it undertakes but will be formed under the risk transformation regulations and not the Companies Act.

- 3.6. Next, Ms Coates addressed the statements released by the Financial Conduct Authority⁵ (“FCA”) and Prudential Regulation Authority⁶ (“PRA”) on authorising and supervising ISPVs. It was explained that the PRA will be the lead regulator when authorising ISPVs but it will require the FCA’s consent before granting approval and FCA will maintain the register of PCC’s.
- 3.7. The fully funded requirements were then discussed. Ms Coates described how, owing to constraints imposed by Directive 2009/138/EC of the European Parliament and of the Council of 25 November 2009 on the taking-up and pursuit of the business of Insurance and Reinsurance (“Solvency II”), the PRA cannot diverge from the requirements in Solvency II for an ILS vehicle to be “fully funded”. The PRA, however, was described as ultimately adopting a reasonably flexible approach to determining whether this requirement is satisfied by taking a case-by-case approach to understanding the proposed funding for the vehicle’s potential liabilities, its investment policy and risk management strategy to determine whether this supports the assumption of risk by that vehicle.
- 3.8. Ms Coates then referred to the challenge of rolling-over capital subscribed to cells from year to year and the evaluation of contingent assets and how these might present potential issues for the regulatory framework.
- 3.9. In her conclusion, Ms Coates noted that much will depend upon how the regulatory framework works in practice. Once that has been observed, the robustness and effectiveness of the regulation can be better evaluated.
- 3.10. When opened to the Forum for questions, one Forum member asked if reinsurance could be considered to contribute to the fully funded requirement. Ms Coates confirmed that reinsurance would not *prima facie* count towards the fully funded requirement on day one but would be considered as a risk mitigation tool. She agreed that this might be considered unhelpful and that this was an area which might be further discussed.

⁵ FCA Statement: “authorising and supervising insurance special purpose vehicles”, (December 2017), available at: <https://www.fca.org.uk/publication/policy/statement-authorising-and-supervising-insurance-special-purpose-vehicles.pdf>.

⁶ PRA Supervisory Statement: “Authorisation and supervision of insurance special purpose vehicles”, (December 2017), available at: <https://www.bankofengland.co.uk/-/media/boe/files/prudential-regulation/supervisory-statement/2017/ss817update.pdf?la=en&hash=505256839818B1CF2DD9D399515A89A1E24F13F9>.

4. Issues of legal uncertainty concerning Part VII transfers in the context of Brexit (James Smethurst).

4.1. James Smethurst delivered to the Forum members a talk on the issues of legal uncertainty concerning the Financial Services and Markets Act 2000 Part VII Control of Business Transfers⁷ in the context of Brexit. He began by stating how there have been concerns regarding the continuity of contracts written by U.K. insurers with E.U. policyholders or over E.U. *situs* risk (and visa versa) pre-Brexit where those insurers lost their authorisation in the E.U. as a result of Brexit. This concern has focused attention on the Part VII process as a way of transferring such policies to an E.U. licensed insurer (or U.K. insurers in the case of insurance policies written by E.U. insurers in the U.K.). There has been relatively little clarity from a jurisdiction to jurisdiction basis on how such legacy policies would be treated, and it is possible that some deal could potentially be reached to ensure existing books of E.U. business can continue to be serviced by U.K. insurers after the U.K. has left the E.U. However, because of the uncertainty that such an agreement will be reached there is focus on the Part VII process and the issues relating to that process. These issues are not the result of Brexit, but Brexit potentially increases their significance.

4.2. Mr Smethurst explained that many of the issues surrounding Part VII transfers are primarily practical or procedural rather than purely legal and include:

- i. the lack of clarity of scope particularly when Part VII is mandated;
- ii. the deadline by which the Part VII process is to be completed by (in the context of Brexit, if a Part VII is not completed prior to Brexit then it will lose its automatic recognition in other E.U. member states);
- iii. the extent of the policyholder communication exercise which must be undertaken;
- iv. splitting policies which cover E.U. risks and non-E.U. risks; and
- v. the recognition of Part VII process in the U.S.

4.3. As these issues are chiefly practical or procedural in nature, it was agreed that it may not be within the remit of the FMLC to investigate this topic further. Forum members

⁷ Financial Services and Markets Act 2000, Chapter 8 Part VII Control of Business Transfers, available at: https://www.legislation.gov.uk/ukpga/2000/8/pdfs/ukpga_20000008_en.pdf.

agreed to recommend that the FMLC write to the FCA and offer to engage with any efforts the authority may make to simplify or streamline the Part VII process by raising issues of legal uncertainty implicit in the Part VII process and addressing solutions or mitigants.

5. Brexit (David Kendall to lead):

a. regulation of the performance of insurance contracts underwritten by branches of European Economic Area (“E.E.A.”) insurers in the U.K. pre-Brexit;

5.1. David Kendall said that as matters currently stand, post-Brexit E.E.A. insurers currently underwriting in the U.K. on a passporting basis will need to gain U.K. authorisation to continue to carry on insurance business, including to pay claims on risks underwritten pre-Brexit. If the E.E.A. insurer failed to obtain authorisation, policy-holders could enforce their contracts but it will be illegal for the insurer to carry it out.

5.2. Mr Kendall outlined a proposal for grandfathering that has been proposed by Insurance Europe. He made it clear, however, that consideration has not been given to how this would affect non-E.E.A. risks and how long any grandfathering would last for.

5.3. An additional option for insurers in the E.E.A would be to withdraw all activities from the U.K. and restructure lines of business so that they are provided from within the E.E.A.

b. authorisation of E.E.A. insurers underwriting in the U.K. pre-Brexit who wish to continue underwriting in the U.K. post-Brexit;

5.4. One key issue highlighted was the timing of when authorisation can be granted for E.E.A. insurers underwriting in the U.K. pre-Brexit who wish to continue underwriting in the U.K. post-Brexit. Particular difficulty was identified in relation to Solvency II.

c. regulation of business underwritten by intermediaries in the U.K. on behalf of E.E.A. insurers; and

5.5. Here, the main question was identified as whether a business can be underwritten and carried out by intermediaries in the U.K. on behalf of E.E.A. insurers where the intermediaries entering a contact are acting as underwriters.

5.6. It was highlighted that old case law on this issue was unhelpful in providing clarity and that it would be vital for the regulators to provide guidance, along with support from the PRA and HM Treasury.

d. placing of U.K.-*situs* risks with E.E.A insurers in the E.E.A post-Brexit.

5.7. Mr Kendall described how in the instance of World Trade Organisation (“WTO”) rules applying post-Brexit, although it may be problematical for U.K. insurers to underwrite risks in certain E.E.A. States, there appeared to be no reason why E.E.A. insurers should not be able to underwrite U.K.-*situs* risks from their home states.

6. Any other business.

6.1. No other business was raised.

Scoping Forums

Your Forum needs you!

Venessa Parekh,
FMLC Research Manager



Registered Charity Number: 1164902.

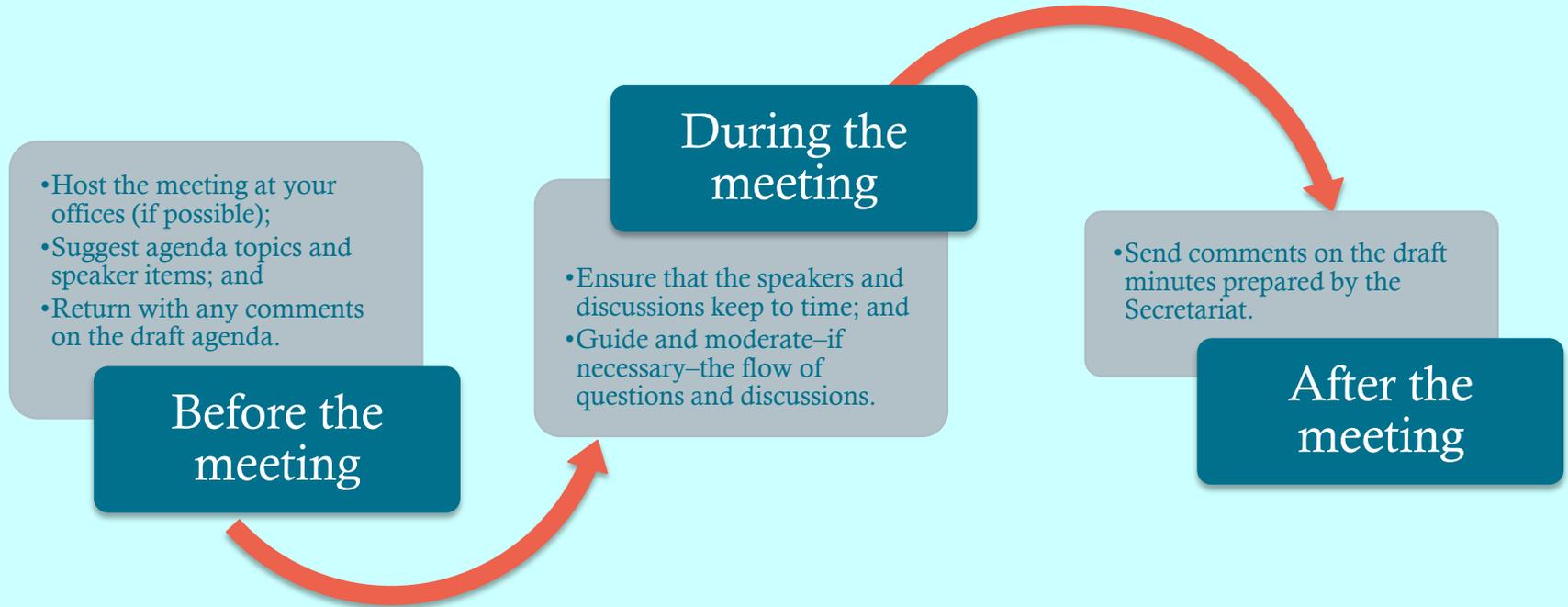
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Your Role in the Scoping Forum

- The role of the Chair
- The role of the Speakers
- The role of the Forum Members



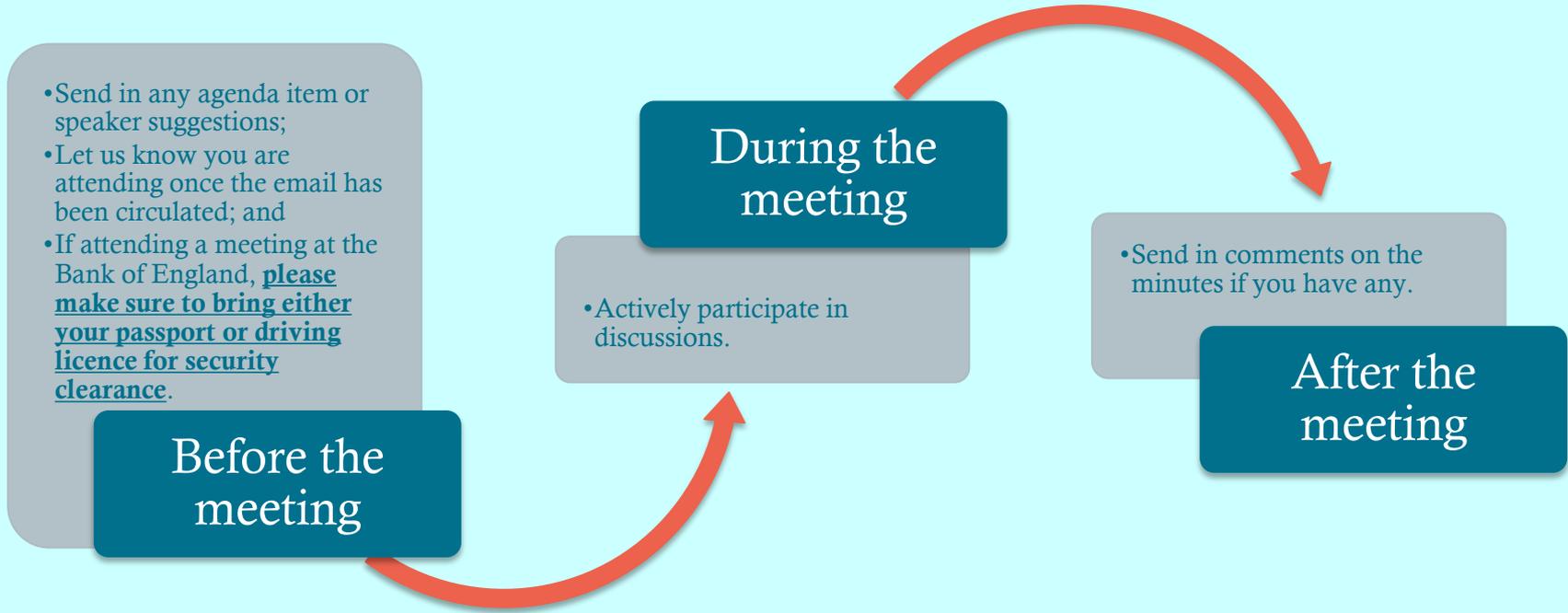
The Role of the Chair



The Role of the Speakers



The Role of the Forum Members



2018 Forward Schedule

Tuesday 20 February

2.00pm to 3.30pm (U.K.)

Tuesday 22 May

2.00pm to 3.30pm (U.K.)

Tuesday 4 September

2.00pm to 3.30pm (U.K.)

Tuesday 20 November

2.00pm to 3.30pm (U.K.)



2018 Forward Agenda



Conclusion / The End

- Get involved!



Financial Markets Law Committee

research@FMLC.org

020 7601 3842