



Financial Markets Law Committee (“FMLC”)

Insurance Scoping Forum

Date: Tuesday 19 February 2019

Time: 2.00pm to 3.30pm

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

In Attendance:

Clare Swirski (Chair)	Debevoise & Plimpton LLP
George Belcher	Skadden, Arps, Slate, Meagher & Flom LLP
Peter Bloxham	
Nigel Brook	Clyde & Co LLP
Pollyanna Deane	Simmons & Simmons LLP
Reid Feldman (dial-in)	Kramer Levin Naftalis & Frankel LLP
Matthew Griffith	RPC
Adrian Hacking	Scor SE
David Kendall	Cooley (UK) LLP
Thomas Lockley	CMS Cameron McKenna Nabarro Olswang LLP
Alison Matthews	Herbert Smith Freehills LLP
Steven McEwan	Hogan Lovells LLP
James Smethurst	Freshfields Bruckhaus Deringer LLP
Jonathan Teacher	Swiss Re Management Ltd, U.K. Branch
Kees van der Klugt	Lloyd’s Market Association
Clare Wiles	FMLC

Guest Speaker

Joanne Etherton	ClientEarth
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Regrets:

Duncan Barber	Linklaters LLP
Katherine Coates	Clifford Chance LLP
Beth Dobson	Slaughter & May
Hilary Evenett	Clifford Chance LLP

Registered Charity Number: 1164902.

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Charlotte Heiss
Adam Levitt
Geoffrey Maddock
Michael Munro
Chris Newby
Chris Sage
Victoria Sander
George Scott

Royal & Sun Alliance Insurance Group plc
Ashurst LLP
Herbert Smith Freehills LLP
CMS Cameron McKenna Nabarro Olswang LLP
AIG Europe Limited
Transatlantic Reinsurance Company
Linklaters LLP
Pacific Life Re

Minutes:

1. Introduction.

1.1. The Chair opened the meeting and asked attendees to introduce themselves.

2. Administration: Update on the Insurance Scoping Forum Elsewhere at the FMLC

2.1. Ms Wiles provided an update on the remit of the Insurance Scoping Forum. She noted that there was interest in discussing various pensions-related matters at the FMLC, and that the Committee and Secretariat had agreed that the most natural fit for these matters would be the Insurance Scoping Forum. The Committee had therefore resolved that the Insurance Scoping Forum would henceforth be the “Insurance and Pensions Scoping Forum”, and would examine issues of legal uncertainty in both the insurance and pensions sectors. Members were requested to send through any nominations for pensions colleagues who may be interested in joining this Scoping Forum. (Note: The Scoping Forum will still be limited to two persons per organisation.)

2.2. Ms Wiles also provided attendees with an update on the recent work undertaken by the FMLC’s other Scoping Forums.¹

3. Climate Change: Legal Implications for Insurers (Joanne Etherton)

3.1. Ms Etherton introduced herself and her organisation, ClientEarth, which uses law and science to prevent climate change and protect the environment. Ms Etherton leads the Climate Finance Initiative, which uses law to drive greater integration to climate-related financial risk. Ms Etherton also provided some background on climate change regulation, including the Paris Agreement.

3.2. Ms Etherton considered that there is a fourfold taxonomy of climate risk, which is relevant for insurers:

- **Physical risk:** Ms Etherton noted that the physical effects of climate change could have a clear impact on markets and drive policy or regulatory changes. There is an evident risk for insurers because physical damage resulting from climate events leads to increased claims and poses a risk to the value of the insurer’s assets. In this respect, physical climate risk may impact both sides of an insurer’s balance sheets.
- **Transition risk:** Ms Etherton observed that, as nations move to low or zero carbon economy to meet the Paris Agreement goals, financial assets and capital returns will

¹ See Appendix I below.

be affected. She listed various possible consequences for insurers, such as policy changes that may reduce the value of the asset portfolios, market changes, competitive pressures and changes in consumer demand (e.g. a reduction in insurance demand in carbon-intensive sectors).

- **Litigation risk:** Parties suffering loss due to climate risk may try to make claims against entities they consider responsible for such climate risk. Alternatively, the parties may bring claims against firms for failing to disclose climate risk. Insurers could find themselves on the hook for such third party claims. Ms Etherton noted that although this is a new area of law and such claims have largely been unsuccessful so far, they reflect a shift in the market's attitude towards climate litigation risk.
- **Reputational risk:** There is increased public scrutiny around climate risk and insurers need to consider the possible reputational effects of this. By way of example, Ms Etherton noted that many insurers are moving away from underwriting coal, but still retain investments in coal in staff pensions plans, creating—as she sees it—a possible reputational risk.

3.3. Ms Etherton then discussed the disclosure and transparency requirements regarding climate change, emphasising the need for proper disclosure to ensure investors can make informed decisions and the market can better price assets. She discussed the Task Force on Climate-related Financial Disclosures (“TCFD”), which was established by the Financial Stability Board to set out voluntary, consistent financial-related climate change disclosures. The TCFD has a number of pillars regarding strategy, governance, risk management, metrics and targets, and has a specific section for insurers. Ms Etherton commented that ClientEarth considers climate change to be a “principal risk” facing insurers and, therefore, insurers are legally obliged to make disclosures regarding it in their Annual Reports.

3.4. Ms Etherton noted that ClientEarth has made complaints to the FCA regarding the failure of three different insurance companies—specialising in life insurance, motor insurance and property insurance respectively—to comply with these disclosure and transparency requirements. Ms Etherton observed that the FCA and PRA have been increasingly vocal about climate risk, and that the FCA Discussion Paper (DP18/8) on Climate Change and Green Finance noted some points that ClientEarth had raised in the aforementioned

complaints.² Ms Etherton reflected that there needs to be an improved understanding of—and better reporting on—climate risk in the insurance industry.

3.5. Attendees raised various questions in the following discussion. One attendee queried whether insurers are trying to develop products that are more sensitive to natural catastrophes in countries where there is a shortage of insurance cover. Attendees discussed efforts driven by the public sector and micro-insurance and considered growth opportunities in this area.

3.6. Additionally, attendees considered the “law of unintended consequences” and the risk that, in the face of climate risk, insurers may significantly increase premiums. Attendees contrasted insurance for climate risk with insurance for terrorism, and discussed whether climate risk could legitimately be deemed “out of our control”. Attendees also considered the extent to which insurers account for possible material changes in their business, and how this is factored into insurers’ market risk models.

4. Contract Continuity post-Brexit (David Kendall)

4.1. Mr Kendall began by outlining the scope of his presentation, namely the performance of insurance/re-insurance contracts where there is EEA risk insured and which are already underwritten pre-Brexit. Specifically, issues of legal uncertainty arise with contracts insuring EEA risk underwritten by the U.K. insurer pre-Brexit, where the U.K. insurer is not authorised to perform those contracts in the EEA post-Brexit. “Performance”, with respect to insurance contracts, covers both the handling and payment of claims, and lack of authorisation may affect both aspects of performance. Mr Kendall discussed various possible solutions to this issue of uncertainty regarding authorisation, including:

- Part VII transfers: This potential solution addresses the issue of authorisation to perform the contract. A difficulty with using Part VII transfers to address the authorisation issue is that some insurance contracts insure risk both in and outside the EEA. Under a Part VII transfer, these contracts would need to be split out so that only EEA risk would be covered by the EEA insurer. This may be problematic in, e.g., a situation where a claim covers both jurisdictions.
- Contract continuity clauses: Mr Kendall considered two types of “contract continuity clauses” that can be used to address the authorisation issue: a “replacement carrier clause” and a “contingent carrier clause”.

² Available online: <https://www.fca.org.uk/publication/discussion/dp18-08.pdf>.

- Pursuant to a “replacement carrier clause”, the U.K. insurer, on entering into a contract, undertakes to find an EEA insurer, should the U.K. insurer be unable to perform the contract post-Brexit. Mr Kendall thought, however, that such a clause would likely amount to a scheme to transfer business from the U.K. insurer to the EEA insurer and so constitute a Part VII transfer (requiring Court approval and raising the issues identified above).
 - Pursuant to a “contingent carrier clause”, both U.K. and EEA insurers are party to the contract when it is underwritten. The “contingent carrier clause” provides that if the U.K. insurer cannot perform because of Brexit, the EEA insurer will step in and perform the contract. This avoids the Part VII issue because both insurers are parties when the contract is underwritten (and so there is no transfer of business upon Brexit). The difficulty lies in whether a “contingent carrier clause” can be added to a policy that is already underwritten by a U.K. insurer. This would likely still constitute a Part VII transfer because the U.K. insurer would be seeking to add a new insurer to the already-underwritten contract.
 - Performance Bond: An EEA insurer could insure the risk that the U.K. insurer cannot perform its obligations under the underlying insurance contract post-Brexit.
- 4.2. Mr Kendall discussed the “Performance Bond” solution in more detail. He noted that the U.K. insurer will usually be reinsuring the EEA insurer in respect of that risk, and so all liabilities will flow back to the U.K. insurer. As the U.K. insurer will remain directly liable to the policyholder, there is no transfer of business and so a Part VII transfer is not necessary. Mr Kendall also noted that the U.K. and EEA insurer should have the same claims handling agent, to ensure the process operates smoothly from the policyholder’s perspective. Mr Kendall observed, however, one problem with this solution: it requires brokers and policyholders to take out a new policy with the EEA insurer (even if the U.K. insurer has agreed to pay for the premium). A possible solution to this problem is for the EEA insurer to issue a deed poll policy: the policy is taken out by way of deed, and so there is no need for consideration, and the policyholder can enforce this deed against the insurer. Mr Kendall also noted that the “Performance Bond” solution may raise various issues of uncertainty regarding the scope of reinsurance available.

4.3. In the discussion that followed, attendees discussed the “Performance Bond”/deed poll strategy in more detail. It was noted that this would typically be used intragroup, although it could be used with third parties as well. The deed policy is also meant to have enduring exposure.

4.4. Attendees also discussed the recent guidance from EIOPA on the insurance sector in light of Brexit (the “**EIOPA Guidance**”).³ One attendee commented that the EIOPA Guidance was not particularly helpful, except with respect to legacy business where U.K. policyholders have changed their habitual residence or place of establishment to an EU27 Member State (as the guidance asked that such policyholders be looked on more favourably). Another attendee noted that the EIOPA Guidance adopted a more moderate approach to run-off, and suggested that competent authorities should either create a framework for run-off or require U.K. insurers to seek authorisation. Attendees also discussed the approach in the EIOPA Guidance to Part VII transfers that have begun (but are not completed) before Brexit: the EIOPA Guidance notes that such transfers should be allowed to continue. Finally, an attendee observed that the EIOPA Guidance suggested that the authorisation of certain third-country branches could be fast-tracked. One attendee also referenced legislation in France that has been developed along the same lines of the EIOPA Guidance.

5. Lloyd’s market Brexit contingency plans/Part VII scheme (Kees van der Klugt)

5.1. Mr van der Klugt provided a brief update, from the Lloyd’s Market Association (“**LMA**”) perspective, on Lloyd’s Brexit planning and Part VII transfer. The preliminary hearing regarding this Part VII transfer was held in November 2018. No roadblocks were raised and so Lloyd’s is proceeding with the Part VII transfer, which is an expansive project. The aim is to transfer all of Lloyd’s EEA business to Lloyd’s Brussels, and then to reinsure this.

5.2. Mr van der Klugt noted that there are various internal issues such as splitting out policies and the reinsurance programs of syndicates. Managing agents (which LMA’s members all are) will be drawn into the central effort. The LMA has set up a cross-disciplinary group from various managing agents. This group is acting as a sounding board for Lloyd’s, and is advising on data held and on other issues such as reinsurance.

5.3. Mr van der Klugt also flagged various other issues inherent in the Part VII transfer, including timing (and whether the transfer could be completed before EIOPA’s recommended transition period expires) and the impact of the transfer on brokers.

³ Available online: https://eiopa.europa.eu/Publications/Standards/EIOPA-BoS-19-040_Recommendation_Brexit_final.pdf.

6. Plenary discussion on recent and anticipated legislation and developments in the insurance sector – potential areas of focus and recommendations for work for the Insurance Scoping Forum in 2019 (led by Clare Swirski)

- 6.1. The Chair then led a brief plenary discussion on issues that the Scoping Forum might focus on in the upcoming year. The Chair had prepared a note with Brexit- and non-Brexit-related issues for the insurance industry to consider. The consultation by the Department for Work and Pensions on defined benefit/pension scheme consolidation, as a possible alternative to insurance companies, was flagged.
- 6.2. Two attendees noted that they had followed up with EIOPA on an issue of uncertainty discussed at the last meeting of the Insurance Scoping Forum: with respect to guarantees from parent companies, whether there is a mismatch between the treatment of insurance companies and the treatment of banks. EIOPA had agreed that this issue needed to be addressed, and it was hoped that there might be an answer by the next meeting of the Scoping Forum.
- 6.3. Another attendee commented that there are issues of legal uncertainty in the insurtech sphere, and the regulation of APIs. It was agreed that this could be a key area of focus for the Scoping Forum, although it is not yet clear how this area will evolve.
- 6.4. Finally, one attendee commented that “disloyalty” premiums on renewal rates may be a topic of interest.
- 6.5. It was agreed that the Secretariat would circulate the Chair’s note to the Scoping Forum, and that members should suggest topics to the Secretariat to be discussed at the next session and to be focused on in the upcoming year.

7. Any other business.

- 7.1. No other business was raised.

Elsewhere at the FMLC ...



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Addressing legal uncertainty



Since 2003, the FMLC has analysed and made recommendations to resolve legal uncertainties in 222 disparate topics.



Remit and Scope



“The role of the Financial Markets Law Committee (the “FMLC” or the “Committee”) is to identify issues of legal uncertainty, or misunderstanding, present and future, in the framework of the wholesale financial markets which might give rise to material risks, and to consider how such issues should be addressed.”

FMLC Founding Documents, September 2002

The FMLC’s remit covers the entirety of the wholesale financial markets. In order to identify issues of legal uncertainty, the FMLC Secretariat runs nine “horizon scanning” Forums, each focused on a specific area of the financial services.

We thought you might be interested in the recent priorities of the other Forums.

Asset Management



- Established to provide a space for discussion of current and future issues of legal uncertainty that are of concern to the asset management industry.
- In recent months, the Forum has considered:
 - Scope of the definition of “user” under the Benchmarks Regulation;
 - Scope of the definition of “institutional investor” under the Securitisation Regulation; and
 - The FCA consultation paper on illiquid assets and open-ended funds.

Banking



- Originally established to review the European banking reform package which proposed fundamental changes to E.U. legislation on bank resolution and bank capital.
- In recent months, the Forum has considered:
 - The European legislative proposal for a Directive on credit services, credit purchasers and the recovery of collateral;
 - The preparations by the loan market ahead of the discontinuation of LIBOR; and
 - Draft secondary legislation incorporating relevant E.U. law into U.K. statute books.

Brexit

- Established to provide a space for discussion of current and future complexities affecting the financial markets as a result of the U.K.'s secession from the E.U. This group is also tasked with providing advice and guidance to the FMLC on the scope and nature of work which C relating to the referendum and consequential withdrawal.
- This Forum has considered:
 - The options for the U.K.'s future relationship with the E.U.;
 - The European Union (Withdrawal) Bill (now enacted); and
 - HM Treasury's preparations for withdrawal by way of the publication of secondary legislation "onshoring" E.U. law

FinTech



- Established to encourage discussion of current and future issues of legal uncertainty arising in the context of technological innovations in financial markets.
- Recently, this Forum has discussed:
 - The evolution of U.S. regulatory position on cryptocurrencies;
 - ISDA’s recent report on smart contracts;
 - New regulations in Gibraltar on the use of DLT and tokens; and
 - The FCA’s consultation on cryptoassets and the U.K.’s regulatory perimeter.

Infrastructure



- Established to provide a space for discussion amongst market infrastructure bodies and a channel of communication between the market infrastructure sector and the public authorities.
- Recently, this Forum has discussed:
 - ESMA Q&As on the Benchmarks Regulation;
 - ESMA Public Statement on managing the risks of a no-deal Brexit in the area of central clearing;
 - The Draft Payments and electronic money(Amendment) (EU Exit) Regulations; and
 - The Draft Central Counterparties (Amendment, etc., and Transitional Provision) (EU Exit) Regulations 2018.

Insurance



- Established to identify current and future issues of legal uncertainty that are of concern to the insurance industry.
- Recently widened to bring into scope the pensions industry.
- This Forum's priorities over the past year include:
 - The development of cyber insurance;
 - The impact of Brexit on existing insurance contracts; and
 - The PRA's consultation on credit risk mitigation

Securities Markets

- The FMLC resolved in January 2019 to establish a new Forum for horizon scanning purposes in respect of the primary markets
- The Forum will consider topics including the aspects of MiFID II and MAR which impact on primary markets, the Prospectus Regulation and PRIIPS, non-MiFID primary markets conduct, infrastructure financing and securitisation issues.



Quarterly Discussion Forum

- The Quarterly Discussion Forum call is a bilateral teleconference between the FMLC and the Financial Markets Lawyers Group (the “FMLG”, associated with the New York Federal Reserve).
- In recent months, topics discussed on these calls have included Brexit, the phasing out of LIBOR and the development of alternative reference rates, and the Benchmarks Regulation.
- This is a “closed” Forum in the sense that it does not have a standing membership and is usually attended by Members of the FMLC. The Secretariat would be grateful, however, to hear from persons who might volunteer to attend as a guest speaker.

Sovereign Debt



- Established to provide a space for ongoing discussion regarding legal uncertainty issues affecting sovereign debt under English, European, international and, possibly, foreign law.
- Last year, this Forum:
 - Welcomed guest speakers, Lee Buchheit and Mitu Gulati, to discuss the Venezuelan debt crisis;
 - Considered the “odious debt” defence; and
 - Discussed a proposal to make “secret” loans unenforceable.

Conclusion



- If you wish to enquire about your firm's participation in any of the Scoping Forums, please do get in touch.
- The Secretariat is always pleased to receive recommendations for topics for discussion or guest speakers.

Financial Markets Law Committee

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