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## Corporate Insurance Newsletter

May 2014

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### UK

#### **FCA publishes TR14/9: Commercial insurance intermediaries - conflicts of interest and intermediary remuneration**

On 27 May 2014, the FCA published a [report](#) summarising the findings of its thematic review which looked into whether insurance intermediaries serving small to medium-sized enterprises (SMEs) are able to effectively identify and mitigate conflicts of interest arising from their remuneration structures.

The FCA found a number of issues and unmitigated conflicts that could result in intermediaries prioritising their own interests over those of their SME customers. These included:

- the structure of some intermediaries' businesses and sources of revenue created significant conflicts of interest, particularly where firms or groups fulfilled multiple roles in the distribution chain and acted as agent for both the customer and insurer in the same transaction;

- in some intermediaries the control framework and management information have not developed in line with changes in the business model, and were therefore no longer suitable for the size and complexity of the business;
- many intermediaries relied on disclosure as the main way to address conflicts of interest rather than having effective control frameworks that prevent conflicts of interest working against customers' interests;
- disclosure provided to customers was sometimes very generic and unlikely to meet their information needs or enhance their understanding; and
- conflicts of interest were not always effectively mitigated in relation to add-on insurance or services, premium finance or where the cost of insurance is borne by a third party.

The FCA says that its research suggested that many SME customers do not fully understand the role being performed by their intermediary and how this might have changed in recent years. Many customers still perceive their intermediary as an independent advisor working as their agent and seeking quotes from a number of insurers, even where this may not be consistent with the nature of the relationship described in the disclosure that they had received.

The FCA is taking the following actions as a result of its findings:

- supervisory engagement with the firms involved to address specific issues identified, using the full range of regulatory tools available to the FCA as appropriate;
- providing this feedback to the wider industry to illustrate potential shortcomings with existing approaches to managing and mitigating conflicts of interest and engaging proactively with the industry to enhance understanding of its rules and expectations, via industry forums and trade bodies;
- providing further information and education to SME customers highlighting its findings and their rights;
- feeding its findings into its planned thematic work on commercial claims.

Whilst the FCA's review focused on larger firms, the FCA says that it expects all general insurance intermediaries to reflect on how they manage the conflicts of interest arising within their business model in the context of its findings and concerns set out in the FCA's review, and to make any necessary changes required to ensure that they are complying with the existing regulatory requirements in this area.

### **FCA publishes TR14/8: Insurers' management of claims - household and retail travel**

On 22 May 2014, the FCA published a [report](#) summarising the findings of its thematic review into claims handling in household and retail travel insurance, which assessed the extent to which consumers as claimants are at the heart of insurers' businesses.

The FCA found that, across all of the policyholders surveyed, 64% were either satisfied or very satisfied with their experience, which the FCA says that it sees as broadly positive. The FCA also found a number of areas where insurers could further increase consumer satisfaction. The key issues to emerge were:

- recording and use of inbound claims calls (mainly household);
- communication and ownership throughout the claim;
- management of supply chains (household);
- the emergency assistance activities of travel insurers and the need for the right insurance;
- insurance in relation to medical conditions (travel);
- consumer outcomes in long chains of delegation;
- the clarity of product documentation.

The FCA says that it expects insurers to reflect on the detailed findings in the report and consider how they can respond within their own businesses and, where appropriate, collectively as a sector. The

FCA also says that insurers should also expect that it is likely to want to discuss claims with them as part of its ongoing Pillar 1 supervisory work.

Building on the findings of this work, the FCA will undertake thematic work later this year to consider whether the expectations of commercial customers, particularly smaller businesses, are met in the claims process, where poor behaviours could lead to poor customer outcomes and have a wider impact on trust in the market.

The FCA has also published two related research papers. These are a [report](#) by Harris Interactive on the experience of insurance claimants and a [report](#) summarising the results from two short online surveys, one relating to travel insurance claims and the other to household insurance claims, completed by members of the Chartered Insurance Institute.

### **Article by the Governor of the Bank of England on regulating the insurance industry**

On 22 May 2014, the Bank of England published an [article](#) written by its Governor, Mark Carney, on regulating the insurance industry.

Among other things, Dr Carney said that:

- the insurance sector faces challenges in adjusting to the post-crisis landscape. These challenges come alongside post-crisis regulatory reforms, and legislative changes that challenge insurers' business models. These challenges could lead insurance companies towards new classes of business, less traditional types of investments, or new opportunities in emerging markets. Dr Carney says that this is not necessarily a problem, but the Bank of England, through its subsidiary the PRA, will be vigilant to the risks in any such moves. The PRA's supervisors take a forward-looking and judgment-based view of whether insurers' business models and strategies could threaten policyholders, or the wider financial sector in future. If the supervisors think that the action taken by an insurer's management today may pose a risk tomorrow, they will not hesitate to step in;
- the PRA will not protect insurance companies from the consequences of their own decisions. Dr Carney said that it is for boards to run their companies, and for those who manage insurers to be accountable for their actions if things go wrong. The PRA will therefore create a regime holding senior managers in the insurance industry to account, which will be similar to the regime created to hold senior bankers to account;
- the UK already has some of the most robust and comprehensive standards for the capital buffers the PRA expects insurers to hold. The PRA is also working towards global capital requirements so as to ensure that insurance companies operating around the world are consistently strong. International co-operation is vital in negotiating common standards and the PRA is taking a leading role to ensure that the UK's voice is heard. Its aim is to create as level an international playing field as possible;
- the PRA does not regulate to prevent the failure of insurers. Its role is to make sure that failing insurers do not harm their policyholders, cost the taxpayer money or make insurance harder to obtain.

### **ABI publishes revised guide to good practice for unit-linked funds**

On 19 May 2014, the Association of British Insurers (ABI) published a [revised version](#) of its guide to good practice for unit-linked funds. The guide updates the 2012 version of the guide to take account of the findings of the Financial Conduct Authority's (FCA) thematic review on the governance of unit-linked funds which highlighted the need for greater detail to provide a clearer picture of the standards required to be deemed good practice.

The guide has been revised by an ABI working group in consultation with the FCA and a wide range of stakeholders. The ABI says that it believes that all firms operating unit-linked funds in which their unit-linked policies invest should aspire to follow the guide, taking into account their financial and other

circumstances. Firms will need to review their existing policies and processes and make changes where they think appropriate. The ABI states that by 31 December 2014, firms should have reviewed their operations against the updated guidelines set out in the guide and begun making progress towards following them.

The guide states that the FCA has indicated that it will take account of the guidelines set out in the guide in its supervision of firms that have written unit-linked business. Where firms do not meet these guidelines, it will be incumbent on them to explain the reasons to the FCA.

### **Lloyd's Market Bulletin on enforcement proceedings - framework for enforcement sanctions and costs**

On 12 May 2014, the Society of Lloyd's published a [market bulletin](#) to inform the market about the new framework for setting sanctions and costs orders in Lloyd's enforcement proceedings.

Lloyd's may bring enforcement proceedings in respect of misconduct against those who are subject to Lloyd's enforcement jurisdiction. It has previously set out, in market bulletin Y4202, its principles of enforcement to give guidance as to the type of cases that may result in enforcement action.

Where enforcement proceedings are brought Lloyd's and the defendant may agree settlement terms to seek to resolve the case without the need for a contested hearing. The settlement terms will include the appropriate sanctions to be imposed on the defendant.

The sanctions to be offered to a defendant for settlement purposes are determined by the Lloyd's Market Supervision and Review Committee (the MSARC). The MSARC has therefore prepared the framework to set out MSARC's approach for establishing the appropriate level of sanctions Lloyd's will seek going forward. The framework includes specific discounts for early settlement. It also refers to Lloyd's approach to costs recovery.

In preparing the framework, the MSARC has considered the approach taken by both the Financial Conduct Authority (FCA) and the Prudential Regulation Authority (PRA) in determining the level of penalties in their enforcement proceedings. While the MSARC has adopted a similar approach to the FCA/PRA process, its framework takes into account the specifics of Lloyd's enforcement objectives. This includes the emphasis Lloyd's places on suspension from the market as being a key enforcement sanction.

The new framework is intended to provide greater transparency regarding the sanctions in Lloyd's enforcement cases. It is also likely that the adoption of the new framework will result in higher sanctions being sought in the future. The MSARC believes that this is right to ensure that the Lloyd's enforcement process continues to be robust and promote high standards of regulatory and market conduct.

The market bulletin says that it should be noted that any settlement agreed between the parties is subject to the consideration of the independent Lloyd's Enforcement Board, which may confirm, reject or propose modifications to the terms of a settlement.

## **INTERNATIONAL**

### **EIOPA updates documents for the insurance stress test**

On 28 May 2014, the European Insurance and Occupational Pensions Authority (EIOPA) published the following documents relating to its insurance stress test 2014, which it launched on 30 April 2014:

- an [updated version](#) (version 1.2), dated 28 May 2014, of its insurance stress test 2014 specifications document, with tracked changes to the version published on 21 May 2014;
- a [second set of questions and answers](#) on the stress test, dated 28 May 2014;

- an [updated version](#) (version 3) of the stress test 2014 reporting template, plus an [automatic updater](#) (version 3) for already completed templates, both dated 28 May 2014;
- an [updated version](#) of the Excel table to support the generation of risk-free curves required for stress test purposes, dated 28 May 2014;
- a [presentation](#) on the stress test 2014 supporting material, dated May 2014;
- a [presentation](#) given at an EIOPA workshop on the stress test 2014, dated 20 May 2014.

The EIOPA [webpage](#) on the insurance stress test 2014 has been updated to refer to these materials. The webpage states that in future, updates will be made every Wednesday and that the technical specifications [webpage](#) should also be checked for updates on a regular basis.

### **EIOPA initiates comply or explain process on guidelines on complaints-handling by insurance intermediaries**

On 16 May 2014, EIOPA [announced](#) that it has initiated the “comply or explain” process on its [guidelines](#) on complaints-handling by insurance intermediaries.

The guidelines are subject to a comply-or-explain procedure whereby competent authorities are expected to make every effort to comply with them. During a two month period each competent authority will need to confirm whether they comply or intend to comply with the guidelines. In the event that a competent authority does not comply or does not intend to comply, it will need to inform EIOPA, stating its reasons. EIOPA will publish the fact that a competent authority does not comply or does not intend to comply with that guideline or recommendation. EIOPA may also decide, on a case-by-case basis, to publish the reasons provided by the competent authority for not complying with that guideline or recommendation.

### **EIOPA publishes discussion paper on conflicts of interest in PRIIPs**

On 21 May 2014, EIOPA published a [discussion paper](#) on conflicts of interest in direct and intermediated sales of insurance-based investment products (PRIIPs).

The discussion paper has been published following a [request for technical advice](#), together with a [mandate](#), both dated 19 May 2014, from the European Commission on possible delegated acts on conflicts of interest in the distribution of insurance-based investment products, as introduced as an amendment to the Insurance Mediation Directive (IMD) by the MiFID II Directive.

By amending the IMD, Article 91 of the MiFID II Directive aims to lay down similar requirements of consumer protection for the distribution of investment products and insurance products that have an investment element. A delegated act is foreseen both in MiFID II as regards conflicts of interest of investment firms and in the amended IMD as regards conflicts of interest of insurance intermediaries and insurance undertakings.

The Commission has made an equivalent request to the European Securities and Markets Authority (ESMA) on possible delegated acts concerning MiFID II as regards conflicts of interest of investment firms, among other issues. EIOPA is requested to co-operate with ESMA in preparing its advice, bearing in mind the specificities of insurance-based investment products and their distribution.

The discussion paper focuses solely on conflicts of interest as introduced by the amendments to the IMD and on the two issues on which the Commission has requested technical advice:

- criteria for identifying types of conflict of interest that might harm customers; and
- steps to be taken in identifying, preventing, managing and disclosing conflicts of interest.

The discussion paper says that specific issues arising related to insurance distribution activities should also be taken into account and identifies two areas in particular: questions on proportionality and on the handling of third party payments (inducements).

Comments are requested by 22 July 2014. EIOPA will consider the feedback and prepare its advice to the European Commission, with a further consultation on its conclusions in the autumn. EIOPA is required to provide its final technical advice to the Commission by 13 February 2015.

### **IAIS publishes questionnaire for self-assessment and peer review on regulation and supervisory measures**

On 21 May 2014, the International Association of Insurance Supervisors (IAIS), updated its consultations [webpage](#) to give the information that IAIS members are invited to complete a questionnaire (see link on webpage) for the self-assessment and peer review on the thematic topic of supervisory measures, covering Insurance Core Principles (ICP) 9 (supervisory review and reporting), ICP 10 (preventative and corrective measures) and ICP 11 (enforcement).

The deadline for completing the questionnaire is 17 June 2014.

### **Presidency publishes a compromise proposal for IMD2**

On 14 May 2014, the Presidency of the Council of the European Union published a [compromise proposal](#) relating to the European Commission's proposed Directive amending the Insurance Mediation Directive (known as IMD2).

This is the first Presidency compromise on this proposal. The cover note for the compromise proposal, which is dated 13 May 2014, indicates that changes to the original Commission proposal are marked in underlined bold text and deletions are struck through.

## **SOLVENCY II**

### **Omnibus II Directive published in the Official Journal**

On 22 May 2014, the text of the [Omnibus II Directive](#) was published in the Official Journal of the European Union. The Directive, which among other things amends the Prospectus Directive and the Solvency II Directive, entered into force on 23 May 2014, that is, the day after it was published in the Official Journal. It must be transposed into national law and regulation by 31 March 2015 and applied from 1 January 2016.

### **EIOPA updates timeline for first set of guidelines**

On 31 January 2014, EIOPA announced [details](#) of its timeline for the delivery of the Solvency II implementing technical standards (ITS) and guidelines. EIOPA is dividing the both the ITS and guidelines into two sets.

On 27 May 2014, EIOPA published [slides](#) on the first set of guidelines which were presented at a meeting of its Insurance and Reinsurance Stakeholder Group on 29 April 2014.

EIOPA's first set of Solvency II guidelines includes guidelines on technical provisions, own funds, the solvency capital requirement, valuation, internal models, governance and the own risk and solvency assessment, equivalence and the supervisory review process.

### **EIOPA update on data point model and XBRL taxonomy design**

On 28 May 2014, the EIOPA updated its [webpage](#) on the Solvency II reporting format to give updated information on the data point model (DPM) and XBRL taxonomy design that have been developed in accordance with the EIOPA guidelines on submission of information to national competent authorities. The webpage contains a link to a [zip document](#) containing the updated DPM and the updated XBRL taxonomy.

Feedback on the updated information is requested by 11 June 2014. EIOPA says that the principles, rules and design approaches used in the current publication are still under consideration and subject to further changes.

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