CITY OF LONDON LAW SOCIETY

INSURANCE LAW COMMITTEE

Minutes of the meeting that took place at the office of Herbert Smith Freehills, Exchange House, Primrose Street, London EC2A 2HS on Tuesday 3 December 2013 from 17:00 to 19:10.

Present:

Richard Spiller – Holman Fenwick Willan LLP ("**RS**") (Chair)
Beth Dobson – Slaughter and May ("**BD**")
Christopher Foster – Herbert Smith Freehills LLP ("**CF**")
Jonathan Goodliffe – Freshfields Bruckhaus Deringer LLP ("**JG**")
Philip Hill – Clifford Chance LLP ("**PH**")
Ken McKenzie – DAC Beachcroft LLP ("**KM**")
Michael Mendelowitz – Norton Rose Fulbright LLP ("**MichaelM**")
Terry O'Neill ("**TO**")
Jonathan Teacher ("**JT**")
Christian Wells – Hogan Lovells International LLP ("**CW**")
David Wilkinson – Kennedys Law LLP ("**DW**")

In attendance:

David Hough – CEO of LIIBA ("**DHough**")
Will Reddie – Holman Fenwick Willan LLP (Secretary)

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1. Apologies for absence

1.1 Apologies were received from Michelle Bramley (Freshfields Bruckhaus Deringer LLP) ("**MB**"), Robert Carr (Greenwoods Solicitors), Stephen Lewis (Clyde & Co LLP) ("**SL**"), Francis Mackie (Edwards Wildman Palmer LLP), Martin Mankabady (Clyde & Co LLP) ("**MartinM**") and Paul Wordley (Holman Fenwick Willan LLP) ("**PW**").

1.2 It was noted that PW had become RS's alternate and that, as a result of his move to Clyde & Co LLP, MartinM had become SL's alternate.

2. Approval of minutes of meeting of 3 September 2013

CF proposed minor amendments to the minutes of the meeting of 3 September 2013. Subject to the relevant amendments being made, the minutes were approved.

3. Matters arising from previous meetings

(a) Update on Law Commission's proposals for Insurance Contract Law reform (Richard Spiller)

3.1 RS reported that he had met David Hertzell ("**DHertzell**"), the Law Commissioner for Commercial and Common Law, at the end of October to discuss the Law Commission's proposals for Insurance Contract Law reform. RS updated the Committee on the Law Commission's proposals:

(a) The draft Bill was expected to be published in early 2014. DHertzell intended to attend the Committee's first meeting of 2014 to discuss the draft.

(b) The final Bill would not be ready before Easter 2014 as the Scottish Law Commission had to review and sign off on it. DHertzell was aiming to get the Bill before Parliament in the summer of 2014. He still intended to use the procedure for uncontroversial bills and believed that the Bill had cross-party support.

(c) DHertzell expected the bill to cover remedies for fraud, damages for late payment, and remedies for non-disclosure and misrepresentation.

(d) DHertzell did not expect the Bill to cover insurable interest or a reform of section 53 of the Marine Insurance Act. DHertzell believed that there was consensus that change was required regarding insurable interest, but there was not yet consensus on what these changes should be. He had stated that section 53 was still particularly controversial and including this in the Bill could jeopardise the whole Bill.

3.2 In respect of section 53, RS reported that the Lloyd's Market Association ("**LMA**") was maintaining that brokers should continue to be liable for premium. However, RS reported that Holman Fenwick Willan had hosted a seminar at which, despite the LMA's position, all of the insurers present had agreed that brokers should not be liable for premium. RS reported that he and DHertzell had agreed that RS should approach Kees van der Klugt of the LMA to discuss the LMA's position.

3.3 TO asked whether the industry was working towards agreeing standard form TOBAs. If so, he considered that these TOBAs were unlikely to be aligned with the position under section 53, so section 53 may fall into disuse. TO considered that this could show the LMA that it had been agreed by its members that section 53 should not apply. However, RS noted that case law suggested that an effective disapplication of section 53 required the policyholder, the broker and the insurer to be party to the agreement, not just the broker and the insurer.

3.4 TO asked about the Law Commission's proposals regarding warranties. RS stated that he expected warranties to be included in the draft bill as they were uncontroversial. MichaelM stated that he believed that DHertzell wanted consumers and business insureds to be treated the same. JG noted that damages for late payment were controversial. MichaelM stated that he believed that the Law Commission was finding it hard to reach a consensus on remedies for fraudulent claims.

3.5 RS considered that there was little point in the Committee debating the Law Commission's proposals at this stage, and that it should wait for the draft Bill to be published.

<u>(b) Update on European Insurance Contract Law reform (Martin Mankabady)</u>

3.6 MartinM was unable to attend this meeting but had emailed in advance to state that he had nothing further to report at the moment. The Expert Group was due to report to the European Commission at the end of 2013. If the report contained anything substantive, MartinM would send an email update to the Committee. If there was nothing substantive to report, he would give an update at the next Committee meeting.

4. Issues for discussion

(a) Conflicts of interest, client assets and IMD2 – discussion to be led by David Hough, CEO of LIIBA

4.1 DHough explained the background to IMD2. He stated that it had originally been proposed in July 2012 but that its progress through the European Parliament had been slow. The main activity had been in September and October 2012 during Cyprus's presidential term but otherwise the European Council had been largely inactive regarding the proposal.

4.2 DHough reported that approximately 600 amendments had been made to the original text but that the amended version was not yet publicly available. He stated that the Economic and Monetary Affairs committee ("**ECON**") was expected to vote on the current version on 17 December 2013.

4.3 DHough stated that elections for the European Parliament were scheduled for May 2014, so progress would cease in approximately March 2014 while Members of the European Parliament campaigned for re-election. DHough explained that if a proposal did not make it through the European Parliament before the Parliamentary session ended, it would be lost. DHough considered that IMD2 was unlikely to pass through Parliament before the closure of the current session, so the current draft of IMD2 was likely to be lost.

4.4 However, DHough reported that various alternatives had been proposed, such as including an amendment to IMD1 in the Markets in Financial Instruments Directive II ("**MiFID II**") in order to incorporate the conflicts and disclosure provisions of MiFID II into IMD1. DHough considered that, if this happened, there may be little interest in enacting IMD2 as a separate Directive.

4.5 DHough briefly explained the scope of IMD2:

(a) It would apply to insurance aggregator websites and to the direct sale of insurance products by insurance companies. DHough reported that there was a broad consensus that this extension of scope was appropriate.

(b) Loss adjusters would not be included within the scope of regulation, and there would be a carve-out for travel insurance providers. Again, both of these proposals were largely non-contentious.

(c) The draft included provisions on conflicts and disclosure, including a proposal for compulsory disclosure of remuneration. This proposal had been discussed at length, as there had been some opposition to a compulsory disclosure regime. ECON's current draft of IMD2 proposed that intermediaries should disclose the nature of their commission and, in respect of general business, should disclose any separate fees received and the source of their commission, but not the actual amounts received. DHough explained that these provisions had been copied from MiFID II.

4.6 RS thanked DHough for his briefing and invited questions from the Committee members.

4.7 JG said that it was interesting to hear that IMD2 could be dropped for a quick fix on IMD1. DHough said that, if IMD1 was amended to incorporate conflicts and disclosure principles (which he considered was the currently preferred approach), there would be comparatively little content remaining in IMD2.

4.8 RS asked whether claims management would fall within the scope of IMD2. DHough said that IMD2 would contain some reference to it, as it formed part of an intermediary's activities.

4.9 DHough also reported that the FCA, EIOPA and the Dutch regulator were keen for insurance investment products (or insurance PRIPs) to be covered by IMD2.

4.10 MichaelM asked what would happen if the legislative process did grind to a halt. DHough explained that a new Parliamentary session would commence in October, so it was unlikely that anything that was not urgent would be addressed before then. In the longer term, DHough considered that IMD2's prospects would depend on whether the Commissioner for the Internal Market was interested in reviving it, but that it could potentially be put on hold for a long time.

4.11 TO asked whether the British government was pushing for a regime on disclosure. DHough said that it was not, and that other member states also had no desire to push for it.

4.12 RS asked whether the FCA was looking at mid-sized brokers. DHough said that it was, and was looking generally at UK brokers in the retail sector (i.e. smaller commercial/personal lines brokers). RS said that the Committee had previously identified brokers and conflicts as a key area for investigation. DHough stated that the FCA had produced a report and held a hearing but that nothing further had happened since then. DHough was not expecting the subject to come back onto the agenda but considered that it could resurface without warning.

4.13 The discussion turned to Ernst & Young's report for the European Commission on pools and line slips and the subscription market. RS explained that the report had concluded that there were no competition problems within the subscription market but that there were competition concerns in relation to pools and line slips.

4.14 DHough explained that the European Commission's insurance block exemption was due to expire in March 2017, so the process of considering whether to extend it would probably start in 2014. DHough considered that, if the exemption was renewed, the definition of "pool" should capture what pools were originally meant to do e.g. write nuclear risks. DHough noted that members of pools were required to assess their market share but that this was often difficult to do in practice.

4.15 RS asked whether a line slip would constitute a pool. DHough considered that, arguably, it could do, as could a binding authority. DHough said that he would prefer the definition of "pool" in any revised block exemption to capture a small handful of pools (e.g. nuclear pools, as previously mentioned) and that other pools should be subject to the standard competition regime.

4.16 RS raised London market quota share reinsurances and wondered whether they were permitted under the competition rules. MichaelM replied that he could see why they might be regarded as pools, although he considered that they were not.

4.17 RS asked DHough what else was on LIIBA's agenda. DHough replied that some amendments to the CASS rules, which had first been proposed many years ago, were expected before Christmas. The amendments would be the first set of rules that the FCA would formally approve, so were being examined by the FCA's competition department. DHough explained that LIIBA supported the tightening of the client money rules and that it hoped to achieve a position where debtors and creditors would be clearly identifiable upon the failure of a broker.

4.18 RS asked what had happened since Deloitte's report on broker financial resources. He asked whether LIIBA was looking at the methods of helping brokers with their financial resources.

DHough explained that it was often difficult to work out the appropriate level of financial resources, as there was little guidance available and the banking rules had effectively just been transposed to the insurance industry. DHough considered that there was some inconsistency in the FCA's assessment of firms, so the level of capital required to be held could depend on when the firm was assessed.

4.19 There were no particular questions, so RS thanked DHough for attending the meeting.

(b) Systemically important insurers (Jonathan Goodliffe)

4.20 JG stated that MB had been due to discuss this subject. JG considered that he was not an expert on the matter and expected that BD would know more.

4.21 JG discussed the FSA's "non-zero failure" principle, which was that prudential regulation was not aimed at preventing failure but at managing it in an orderly way. JG noted that this principle was obviously breached when Lehman Brothers collapsed.

4.22 JG also referred to other issues that had arisen, such as Equitable Life, which had caused public distrust in the financial services market. JG stated that the "non-zero failure" principle had initially focussed on banks, with the aim of preventing the biggest institutions causing more damage than necessary. The principle had then been extended to the insurance sector to achieve consistency across the regulated sector and to avoid regulatory arbitrage.

4.23 JG stated that the Financial Stability Board ("**FSB**") had started to identify global systemically important insurers ("**GSIIs**"), i.e. those whose failure would disrupt the market as a whole. Factors in deciding whether an insurer was a GSII included its size, global activity, interconnectedness, substitutability (i.e. could it be replaced?) and non-traditional activities. The FSB had proposed that the GSIIs it had identified should put together systemic risk management plans.

4.24 The FSB had published a list of nine GSIIs in July 2013 (available in Annex I of: http://www.financialstabilityboard.org/publications/r_130718.pdf). JG and the Committee did not know whether the FSB had revealed the identity of the firms that had been considered for inclusion but ultimately had not been included in the list. A list of globally significant reinsurers was expected to be published in July 2014.

4.25 RS asked what these GSIIs were systemically important to. BD agreed, and considered that it was debatable whether the failure of these GSIIs would have an effect as serious as a failure of a large bank. JG considered that an insurer could be systemically important as its failure could cause a loss of confidence in the insurance sector.

4.26 BD considered that the purpose of identifying GSIIs was to ensure that the GSIIs were better capitalised so that the relevant government would not be required to provide assistance in the event of the failure of a GSII. JT considered that classification as a GSII could be viewed as a statement that it would be too expensive for the government to step in and save the insurer in question.

4.27 MichaelM wondered why, for example, Zurich was not on the list of GSIIs, despite being on the same scale as other insurers on the list. RS stated that he could see Lloyd's and some reinsurers being systemically important, but not some of the insurers that had been classified as GSIIs. JG and MichaelM stated that Sean McGovern had explained that Lloyd's was not a GSII because it was a market rather than an insurer.

4.28 JG stated that the industry's response to the FSB's list had been quite hostile. For example, the Geneva Association had said that, generally, the larger an insurer was, the more diverse it was, so it was inappropriate for the FSB to apply a test based on the size of insurers. CW stated that it seemed that the FSB was trying to apply banking solutions to the insurance sector. JG considered that such a hostile response from the industry was unusual but that this might be explained by the fact that the requirements proposed to be placed on GSIIs were extensive and expensive.

4.29 JG reported that the PRA was looking at the same issue and that its focus seemed to be on the life sector due to the level of funds in with–profits products, but that there were concerns regarding the general sector. The Bank of England and the FSA had said last year that the PRA would work with insurers, the Treasury and the Bank of England to enhance the resolution framework. JG noted that EU legislation had also been proposed, although this was at a very early stage.

4.30 BD agreed with JG's summary and had nothing further to add. RS thanked JG for his summary.

(c) ARIAS's proposals to address the cost of arbitration: the ARIAS Fast Track Arbitration Rules (Christopher Foster)

4.31 CF said that there was some discomfort in the market over whether arbitration was a satisfactory way of resolving (re)insurance disputes. CF explained that arbitration procedures generally followed court procedures, cost a similar or greater amount than court procedures and were dependent on the availability of arbitrators. CF also noted that there had been a fall in the number of arbitrations in 2013.

4.32 CF explained that a task force had been set up in the US to look at the problems with arbitration procedures and to set up a fast-track procedure. CF reported that the ARIAS Fast Track Arbitration Rules had now been introduced. The process under these Rules was as follows:

(a) preliminary identification of issues;

(b) appointment of an arbitrator within 28 days of commencing arbitration;

(c) decision to be made within four months of the start of the process;

(d) a reasoned opinion to be provided within 14 days of the decision being made; and

(e) everything to be dealt with in writing on a documents-only basis.

4.33 CF explained that there had been some debate over whether the Rules should be mandatory and/or whether the process should be set. CF reported that the Rules would not be mandatory and would not be set: they would be agreed by the parties once the process started. He noted that in certain circumstances arbitrators would be able to overrule the agreement between the parties but considered that an arbitrator would have to be bold to do this in practice

4.34 CF considered that the new procedure would be used, but was unlikely to be sufficiently widely adopted to effect a sea-change. RS asked whether parties would need to opt into the Fast Track Rules once the dispute had arisen. CW stated that a clause in the contract between the parties could elect for the Fast Track process. CF noted that parties would need to make sure that the broker was a party to the arbitration agreement to ensure that the broker could be made a party to the arbitration.

4.35 CF also noted that some amendments to the main ARIAS rules would take effect on 1 January 2014. These included replacing references to telex with references to email, and adding references to proportionality and speed.

4.36 There was some general discussion regarding the use of arbitration. MichaelM said that on occasion he had recommended that clients used the Commercial Court rather than arbitration (or at least opted for a sole arbitrator) but that clients tended to be reluctant to use the Commercial Court due to the risk of publicity and often found it very difficult to agree on a sole arbitrator, as generally each party would not trust any suggestions made by the other. CF also noted that clients liked the idea of "commercial men" deciding their dispute, making arbitration more attractive. MichaelM mentioned that the market that ARIAS was aimed at was quite small, so it could be hard to find an available arbitrator once conflicts and availability had been dealt with.

(d) EIOPA's opinion on payment protection insurance

4.37 It was agreed that the Committee had little to say on EIOPA's opinion.

(e) Insurance add-on products

4.38 JG considered that add-on products were an important subject but that something substantive needed to happen (e.g. the FCA publishing the findings of its market study) before the Committee could make a valuable contribution. RS agreed that consideration of the subject should be deferred to a later meeting.

(f) ABI review of the products, information and advice available to people as they reach retirement

4.39 JT considered that it was strange that the ABI was looking at this subject given that the FCA was carrying out a similar review (its thematic review of annuities). RS again considered that substantive reports or proposals were needed before the Committee could discuss the subject.

4.40 JG noted that the FCA's thematic reviews seemed to be informal and not based on set rules. He considered that it was difficult to find out about the scope or substance of a thematic review until the findings were published.

5. Monitoring of sector developments

5.1 The Committee noted several sector developments that had occurred within the last three months.

5.2 JG stated that the adoption of the second Solvency II Quick Fix Directive on 21 November 2013 was very important. He stated that the agreement on Omnibus II that had been reached was extremely complex and might be a topic for a detailed discussion at a future Committee meeting.

6. Committee membership

6.1 The Committee considered the applications of Helen Chapman (Hogan Lovells International LLP), Nigel Frudd (Minories Law) and Chris Jefferis (Ince & Co International LLP) to join the Committee. All of the applications were approved by the Committee. RS agreed to inform the three applicants that they had been approved as members.

6.2 MichaelM asked whether there were any constitutional limits on who could be appointed as a member of the Committee and the number of members. RS confirmed that there was no maximum limit on the number of members. He also confirmed that membership of the Committee was an

individual membership and not a firm membership, but that generally only one member per firm was permitted. RS explained that the CLLS was keen for its committees to have members from a range of firms, a view which RS also held.

6.3 RS confirmed that, as agreed at previous Committee meetings, he had approached several potential members and was waiting to hear back from them about whether they would like to join the Committee. RS considered that, assuming that they wished to join the Committee, the Committee should consider their applications but otherwise should suspend recruitment in order to prevent the Committee membership becoming too unwieldy. RS explained that he would ask the Committee to vote by email on any applications from these potential members so that, if their applications were approved, they could attend the first Committee meeting of 2014, at which DHertzell planned to discuss the draft Insurance Contract Law Bill.

7. Dates and hosts for Committee meetings in 2014

The Committee meetings in 2014 were scheduled to be held at 17:00 on:

(a) Tuesday 25 February at DAC Beachcroft (hosted by KM);

(b) Monday 9 June at Norton Rose Fulbright (hosted by MichaelM);

(c) Tuesday 2 September at Holman Fenwick Willan (hosted by RS); and

(d) Tuesday 2 December at Kennedys (hosted by DW).

8. Any other business

There being no other business, RS thanked CF for hosting the meeting, wished the Committee members a Merry Christmas and declared the meeting closed.