CITY OF LONDON LAW SOCIETY

INSURANCE LAW COMMITEEE

Minutes of the meeting that took place at the offices of Holman Fenwick Willan LLP, Friary Court, 65 Crutched Friars, London EC3N 2AE on Tuesday 6 December 2016 from 17:00 to 19:00.

Present:

Richard Spiller – Holman Fenwick Willan LLP ("**RS**") (Chair)

Andrew Barton – Macfarlanes LLP ("**AB**")

Andrew Bonwick – Kennedys Law LLP (as alternate for David Wilkinson) ("**ABon**")

Beth Dobson – Slaughter and May ("**BD**")

Francis Mackie – Weightmans LLP ("**FM**")

Martin Mankabady – Dentons UKMEA LLP ("**MaM**")

Joanna Page – Allen & Overy LLP ("**JP**")

Victoria Sander – Linklaters LLP ("**VS**")

Michael Mendelowitz ("**MM**")

Terry O'Neill ("**TO**")

Jonathan Teacher ("**JT**")

In attendance:

Will Reddie – Holman Fenwick Willan LLP ("**WR**")

Eilidh Brown – Clifford Chance LLP ("**EB**")

Tamara Goriely – Law Commission ("**TG**")

Stephen Lewis – Law Commission ("**SL**")

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1. **Membership**

RS explained to the Committee that PH had been approved by the CLLS as the new Chair but that as apologies for absence had been received from PH RS would be chairing the meeting.

RS explained that George Swan had been approved as the Freshfields Bruckhaus Deringer LLP representative and that there were two vacancies caused by Chris Foster

leaving Herbert Smith Freehills and Martin Mankabady leaving Clyde & Co. RS suggested that, if PH agrees, the CLLS can advertise for these two vacancies.

RS thanked Michelle Bramley (Freshfields) for her contribution to the Committee.

RS noted that David Webster (RPC) had proposed Matthew Griffith as his replacement and that a CV would be circulated once received.

2. **Apologies for absence**

Apologies were received from George Belcher (Skadden Arps Slate Meagher & Flom (UK) LLP), George Swan (Freshfields Bruckhaus Deringer LLP), Simon Brooks (Eversheds LLP), Helen Chapman (Hogan Lovells International LLP), Simon Garrett (CMS Cameron McKenna LLP), Bob Haken (Norton Rose Fulbright LLP), Philip Hill (Clifford Chance LLP), Chris Jefferis (Ince & Co International LLP), Ken McKenzie (DAC Beachcroft LLP), David Webster (Reynolds Porter Chamberlain LLP) and David Wilkinson (Kennedys Law LLP).

3. **Continuing Discussion Topics**

(a) Law Commission's paper on the issues arising out of the draft Insurable Interest Bill

3.1 RS reminded the Committee that a copy of the Law Commission's draft paper on the issues arising out of the draft Insurable Interest Bill (the "**Bill**") had been circulated prior to the meeting. TG noted that the paper was not yet public and that the Law Commission would welcome any comments from the Committee on the paper.

3.2 VS noted that she was one of the authors of the letter forming the Appendix included in the paper and explained that the key issue was concern that the Bill would result in the delineation between insurance contracts and derivates being lost. VS noted that in particular the draft Bill cast doubts on the third element of the definition, as set out in the *Prudential* case, which now effectively requires that the insured have an insurable interest.

3.3 VS questioned whether the broad wording the Bill uses at clause 5 to repeal all previous law relating to the requirement of an insurable interest would get rid of this third requirement. The concern is that the only thing stopping many derivatives contracts from being classified as contracts of insurance is this third limb, and if the Bill repeals it then such derivatives contracts could be classified as insurance contracts.

3.4 VS explained that it was therefore important to ascertain what the repeal wording means in the context of the common law definition of an insurance contract.

3.5 BD questioned whether it was necessary to have clause 5 at all and to strip away everything relating to insurable interests which came before the Bill. In practice BD noted however that it can be difficult to distinguish between the question of whether you have an insurable interest, and whether you have insurance.

3.6 TG responded to these concerns, saying that this was the Law Commission's third attempt at trying to delineate derivatives contracts from contracts of insurance and

that there was no clear way to do so. TG noted however that the courts have been pragmatic in their approach, and have still found insurance contracts void for lack of an insurable interest.

3.7 TG noted that she was aware of the reliance on the *Potts* opinion. TG explained that she did not think it was necessary to codify the law outside of life insurance, and that Clause 3 of the draft Bill (*Insurance interest: insurance other than life-related insurance*) would be removed. Non-life contracts were not causing any difficulties in this regard, so allowing the courts to develop the law in their own way is the best approach. The real need for change was in life insurance and life-related insurance; there has been no real demand for change from the non-life sector.

3.8 JT questioned whether there had been any discussions with the PRA about this. TG replied that the regulators have relied on the common law definition so are concerned that a change to this would lead to a change in their regulatory structure. TG confirmed that the Law Commission would only do what is really needed, i.e. extend "insurable interest" to the lives of children, grand-children and cohabitees. VS confirmed that she would send a follow-up paper setting out their concerns in this area.

3.9 In respect of Clause 2 of the draft Bill (*Insurable interest: life-related insurance*), TG expanded on the definition of "life-related insurance", explaining that it included annuities and longevity risk and that the current thinking was to remove "living too long" from the definition. This would mean that a longevity swap would not be included, and it would only apply where the risk is death, ill-health or incapacitation, areas where there was a low risk of related derivatives. TG noted that due to the court's pragmatic approach, the insurable interest is in any event not the only delineation between derivatives contracts and insurance contracts. TG noted that the aim of Clause 2 is simply to restate the 1774 Act (which will be repealed). Annuities would be left out the "life insurance" definition and ring-fenced separately.

3.10 JT questioned how a longevity swap would be analysed. TG responded that from recent cases, as there was no precise definition of an insurance contract, the courts had generally said that if it is written by an insurer and looks like an insurance contract then it is an insurance contract. TG noted that an insurable interest could probably be found in many derivatives contracts but that the courts did not treat them as insurance contracts, as the insurable interest just happened to be there. TG further noted that a contract could be a valid insurance contract even if it did not explicitly state that it was.

3.11 JT then asked how the new Bill would treat a transfer of risk by an insurer of pension insurance on the reinsurance market. VS said that she thought it would look through the reinsurance to the subject matter of the insurance and that it would be dealt with in the same way as it is now. This would work equally for a longevity hedge with a bank if it is structured as a derivative.

3.12 The Committee indicated that it had no further questions. JP noted that her derivatives colleagues were also content with the proposed way forward.

<u>(b) The practical consequences of the Insurance Act 2015 coming into force, and the approach of insurers, reinsurers, brokers, policyholders and others</u>

3.13 TO noted that there have been odd things happening in the market to address the Insurance Act 2015 (the "**Act**") as it seems that people are writing into contracts what is already in the statute. TO noted that this approach could be risky, as if anything is even slightly less beneficial to the policyholder then you must go through the contracting out provisions in the Act.

3.14 MaM noted that he had seen this and suggested that it was coming from brokers, pointing out that in reality it often did not strictly replicate the Act and also adds in "without prejudice to the Act" as belts and braces, and that it seemed to be a question of brokers wanting to have their cake and eat it and also achieve market standard language. In particular, MaM has seen:

(a) that brokers are looking to achieve the pre-Act position on remedies in particular and want to be able to charge a higher premium to reduce claims;

(b) that brokers are looking to introduce clarity on which individuals at the insured should be regarded as having knowledge for the purposes of the duty of fair presentation by specifying key individuals in a policy;

(c) that insurers are resisting brokers' requests to confirm that disclosure has been done in a way that is reasonable and accessible;

(d) that brokers have been trying to define a large portion of the policy as the "risk as a whole" to bring it under section 11 of the Act; and

(e) that a duty of utmost good faith is now being used in the context of the duty of fair presentation, rather than just as a guiding principle.

3.15 MM noted that in general, the Act had been well received. The brokers understand that it is a soft market so it is easier to push on terms and conditions than to push on rates. Sometimes however there was some misunderstanding of the Act. MaM noted that some brokers were now having conditions precedent to liability as well as excluding section 11. It was noted that brokers felt they could not accept the Act's position so they were trying to get market standard language. JP noted that she felt it was better to be explicit.

3.16 SL explained that the Law Commission was hoping that the Act would lead to better professionalism in the market, e.g. by encouraging discussions about knowledge and disclosure. MaM noted that in his opinion this has not happened.

3.17 FM explained that underwriters were finding the abolition of the incorporation of the proposal form into the contract difficult – they are still assessing the risk in their mind using the proposal form, but now they have to find and explicitly insert the relevant representations in the contract, which it was felt was a backwards step.

3.18 SL explained that the problem with the proposal form (until the Act came into force) was that insurers were able to deem the contents of the proposal form to be warranties, and any inaccuracy therefore led to the contract being voidable. MaM noted that they could still say that something contained in the proposal form was in breach of the duty of fair presentation.

3.19 MM noted that some were trying to use statements of fact rather than a proposal form, whereby they would say to the insured that it is their duty to make a fair representation, and that the questions had to be answered honestly. MM noted that this was however much easier for a homogenous policy where the risks are obvious.

3.20 RS then asked whether Ergo took the position on s11 that it would only apply where there was causation. MM noted that they actually use the Act language but informally they use a test of causation – for example in the case of a factory fire, where an electrical warranty was found to be incorrect, they would pay out unless it could be shown that the electrics did cause the fire.

3.21 RS noted that instances had been found of brokers choosing New York law to get around the Act, and questioned whether this would put them in a better position. PH said that brokers were under the impression that the Act imposed a greater duty of disclosure and makes the disclosure process more complex, but that this was based on a misunderstanding of how the Act works. MaM noted that he had seen legal opinions stating that this was the case in the context of credit insurance policies.

3.22 TO pointed out that the problem with the previous position was that policyholders had no idea what their duty of disclosure was; therefore it may seem like a greater duty to them as they were now aware of it. SL asked whether anyone had seen an improvement in disclosure procedures. MM and FM thought it was too early to say and that it might be clearer around renewal season, with MM noting that it might be possible to evaluate the effect of the Act on policy claims towards next summer. TO anticipated that most parties will just do the minimum required in terms of disclosure.

3.23 The discussion moved on to proportional remedies. TO noted that this would be interesting as it allows the insurer to say that, given different information, the risk would have been underwritten on specific terms. MM noted that underwriters would have to keep much better notes. JP suggested that underwriters would be able to pick and choose from a spectrum of what would have been done on various different policies. MaM had had e.g. supermarkets looking at this and asking what they should do – they were struggling with whether the Board would need to sign off on everything that was disclosed to brokers? If so, how would this be done?

3.24 FM noted that the bigger brokers were now imposing their own schedules of proportional remedies. These were not necessarily disadvantageous but could be. TO pointed to s17(3), which states that a disadvantageous term must be clear and unambiguous as to its effect, noting that this requirement could not be contracted out of.

3.25 At this point FM made his apologies and left the meeting.

3.26 SL pointed out that there would be two waves of cases (direct followed by reinsurance) and asked for input on whether the market would be guided by judgments once everything settled down. MM agreed, suggesting that it would be a few years. TO noted that the key point in litigation is likely to be the question of what an underwriter would have done had they been provided with the correct information.

3.27 At this point TG and SL made their apologies and left the meeting.

4. **New issues for discussion**

(a) *Simmonds v Gammell*

4.1 MM introduced the topic of *Simmonds v Gammell*, a High Court case arising out of the World Trade Centre attacks. MM explained that the question was whether insurers could aggregate all personal injury claims arising either directly or indirectly out of the event, including respiratory disease claims from rescue workers, for example firemen, that arose from the clean-up. The question was (i) was there one event and (ii) what does "arising out of" mean? MM explained that the arbitrators had come to the conclusion that the attack was not a proximate cause, but a significant cause. Peel in the High Court thought that this was within the acceptable range of responses from the arbitrator. The causal link was clear and obvious and there was no error of law.

4.2 MM explained that he disagreed with Peel's judgment and that it came down to the extent to which an arbitral panel could decide the meaning of an English word (i.e. "arising"). MM reasoned that:

(a) it seemed odd to aggregate claims where the cause, in respect of the rescue workers' respiratory problems, was the failure of the Port Authority to provide proper clean-up gear, rather than an event (unless the original policy included an extended definition of "cause"); and

(b) it was also odd to then aggregate these claims with direct injuries that had clearly been caused by the attacks.

4.3 MM noted that this may go to the Court of Appeal.

(b) *Impact Funding Solutions v AIG*

4.4 MM explained that this Supreme Court case, which considered the interpretation of the "debts and trading liabilities" exclusion in the SRA Minimum Terms and Conditions of Professional Indemnity Insurance, was a borderline decision – it was actually a case of getting a deal wrong rather than professional negligence, therefore the insurers argued that they were not liable.

(c) Insurance Linked Securities Consultation Paper

4.5 RS explained that HM Treasury had published a consultation paper on regulations implementing a new regulatory and tax framework for insurance linked securities, which was followed by a joint consultation paper by the PRA and FCA on the regulators' proposed authorisation and supervision regime for insurance special purpose vehicles ("**ISPVs**"). RS noted that the HM Treasury consultation paper seemed to solve a major weakness, which was the applicable tax regime – the paper now said that the government would exempt ISPVs from corporation tax in relation to insurance risk and that there would also be a withholding tax exemption for foreign investors. RS thought that this was an acceptable suggestion.

4.6 RS further explained that the consultations covered the following areas:

(a) Corporate issues:

(i) directors' duties – these would be as normal;

(ii) reports and accounts – these would be as normal;

(iii) disclosure obligations – as ISPVs are potentially single transaction vehicles, there is a concern that this could result in confidential transactions being disclosed; and

(iv) insolvency – each cell in the Multi-Purpose Insurance Special Purpose Vehicle ("**MISPV**") would be treated separately on insolvency.

(b) Authorisation and supervision – both Solvency II and SIMR would be applicable.

4.7 RS explained that the PRA and FCA were consulting on authorisation and supervision and that the deadline for responding is 23 February 2017, whereas the deadline to respond to the HM Treasury consultation is 18 January 2017. RS noted that the committee should respond and that he was happy to work on this response. BD, VS, JT and MaM all expressed an interest in working on the response. BD explained that she had been to an ILS conference run by City and Financial on 5 December and that the impression was that HM Treasury wanted to get it right and were happy to listen to feedback.

4.8 RS asked the committee how they thought it was best to respond. VS was not sure whether Linklaters would be making a submission and BD confirmed that Slaughter & May would not be. VS suggested that the sub-committee schedule a time to discuss in the first week of January on the basis of key issues from the conference. RS confirmed that he would arrange this meeting. BD and JT agreed to circulate key points from the City and Financial conference.

5. **Monitoring of sector developments**

(a) Solvency II inquiry

5.1 RS explained that a Treasury Committee inquiry into Solvency II had been launched on 13 September 2016. Lord Turnbull had said that the Brexit vote was an opportunity to get rid of Solvency II and RS noted that he had incorrectly been quoted as saying that he wanted to get rid of it.

5.2 VS referred to the Great Repeal Bill, noting that the regulators will not have the time to make any major changes to Solvency II and that it was likely to continue in the same way. VS noted that the feeling at the recent ABI conference was that the market does not want major changes; however, there are some features of Solvency II that are disliked, for example the risk margin. VS noted that there may be proposals to change this but this may happen as part of the European project anyway.

5.3 RS noted that run-off would also be an issue as the PRA would, following a transitional period, then be faced with many run-off companies that do not meet SCR requirements but are still solvent – the PRA would have to work out what to do with these companies as it would not want to be winding them all up. MaM pointed out that where a company is in run-off, Solvency II was still applied where there is a live insurance company in the group. RS believed that there may be some tinkering at the

edges but that there was generally no industry or regulator appetite to make major changes.

5.4 The discussion turned to equivalence, with VS questioning what the real value of equivalence was, noting that it was a political point, but that there was no desire to have equivalence at any price. VS noted that if there was appetite to remove certain parts of Solvency II, there was a risk of the UK not being seen as equivalent. BD agreed that ideally we would want equivalence, but again not at any price.

5.5 MaM pointed out that the USA is very keen to get equivalence. RS noted that the USA is already equivalent for solvency capital but not reinsurance or group supervision. This is significant as BaFin has started to tell reinsurers from non-equivalent jurisdictions that they cannot reinsure a German reinsurer, and this was being echoed by the Belgian regulator. MM questioned how this worked as a reinsurer should be able to write where it likes, however RS noted that in Germany they do not agree to this. This would be particularly significant to US reinsurers with branches in the UK, particularly if the UK does not get equivalence. BD noted that the UK could still be equivalent for reinsurance purposes even without the risk margin.

(b) LMA and IUA guide to the Insurance Act 2015

5.6 MM explained that an updated version of the LMA and IUA guide to the Insurance Act 2015 had been published and that it now included guidance on the *Versloot Dredging v HDI Gerling* judgment, which dealt with the effect of a fraudulent device on a claim. The Supreme Court decided that use of a fraudulent device did not amount to a fraudulent claim so did not invalidate the claim.

(c) *Great Lakes Reinsurance v Western Trading*

5.7 RS noted that the Court of Appeal had handed down its judgment in *Great Lakes Reinsurance v Western Trading*, in which it held that an insured party was entitled to be reimbursed by its insurers as and when it reinstated its insured premises which had been destroyed by fire.

(d) PRA consultation on group supervision

5.8 It was noted that the PRA had issued a consultation paper on 7 November 2016 on amendments to its supervisory statement SS9/15 on Solvency II group supervision and that the consultation closes on 7 February 2017.

(e) PRA consultation on cyber insurance underwriting risk

5.9 It was noted that the PRA had issued a consultation paper on 14 November 2016 on cyber insurance underwriting risk, which sets out the PRA's proposals for a new supervisory statement setting out its expectations for the prudent management of cyber underwriting risk. It was noted that the consultation closes on 14 February 2017.

6. CLLS Committees/Court/Livery Dinner

It was noted that the annual CLLS Committees/Court/Livery Dinner is taking place on 31 January 2017 and that details would be circulated once available.

7. **Any other business**

7.1 MM noted that the FCA had recently published a thematic review on professional indemnity insurance which was worth looking at.

7.2 The meeting dates for the following year were set and will take place on 7 March (to be hosted by Clifford Chance), 6 June (to be hosted by Allen & Overy), 5 September (to be hosted by Slaughter & May) and 5 December (to be hosted by Linklaters).

7.3 There being no other business, the Committee passed its thanks on to RS and WR for their work as chair and secretary of the Committee respectively and thanked RS for hosting.