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Spring 2016

RISK MATTERS

Highlighting topical issues for the insurance sector

Contents

Introduction

Welcome to the 2016 Spring edition of Risk Matters, CMS' regular review of the key issues facing insurance companies, brokers and their clients.

As many readers will know, 110 years of law will be consigned to history when the new Insurance Act comes into force in August. Our article on page 4 reviews the key points in the Act and considers what steps need to be taken in preparation for the change.

Meanwhile, few people in the UK can have failed to notice that, since late last year, we have had more than ten 'named' storms result in up to GBP 2bn[1] in insured losses, causing misery to homeowners and businesses. Policy wordings and claims experts Neil Beighton and Alex Denslow have considered the UK Met Office's new approach of naming storms and reveal how this could be influencing the aggregation of claims by direct insurers onto their excess of loss reinsurers.

2016 also marks a momentous year for trade with one of the Middle East's most potentially powerful nations, as Iran finally became subject to the E3+3 (UK, France Germany, US, Russia and China) Joint Comprehensive Plan of Action and had key economic sanctions relaxed. Sanctions specialists Caroline Hobson and John Markham have provided considerable insight through a number of our publications as this process has developed and now they outline the key risks for insurers looking to take advantage of a new market worth a potential USD 7.4bn in gross premium (according to reports).

With new business opportunities on the horizon, we know it is important to take care of things at home, so this edition of Risk Matters also includes a pair of articles focused on keeping your staff happy and a little housekeeping. Firstly, inspired by a number of landmark relocations in the insurance sector, Mark Heighton reveals what things need to be considered if you are looking at moving headquarters. Second in the series is a focus on employees; again inspired by a number of high-profile team moves, CMS' head of employment Anthony Fincham and Head of the UK Insurance Sector Group Stephen Netherway say companies should protect themselves or risk losing in a 'game of musical chairs'.

CMS also advises major life and pensions institutions and 2016 will see major changes to the way this industry is treated from both a tax and an organisational point of view. Pete Coyne and Amanda Wallbank review the complex issues of VAT recovery and the future of pension taxation, amongst others which promise to have a significant impact on the pensions industry.

In our regular disputes digest, Stephen Netherway, Alaina Wadsworth and Sophie Newman look at the latest innovations in courtroom procedure for business-related litigation.

The final piece in Risk Matters' Spring edition picks up on the weighty issue of the Insurance Distribution Directive, which has now been earmarked for implementation two years from now. We have reviewed all of the important changes and looked at new product oversight guidelines which are currently in consultation with a final report on that expected in Q2 2016.

As ever, we hope you find this edition useful and look forward to receiving any feedback you may wish to send our way.

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[1] Source: Association of British Insurers

Countdown to the Insurance Act 2015

The Insurance Act 2015 will come into force on 12 August 2016 with the majority of its provisions applying to insurance contracts entered into after that date. Amendments to the Act are already in sight, with the Enterprise Bill conducting its passage through Parliament and likely to come into force in 2017. The Act will also lead to the coming into force of the Third Party (Rights Against Insurers) Act 2010, which will impact on insurers and brokers.

No doubt many will have been made aware of the major changes to insurance law in the UK but, with around four months to go until the Act comes into force, the insurance market – insurers, insureds and brokers alike – need to ensure they are prepared for the changes the Act introduces.

Scope of pre-contractual disclosure

The Act retains the requirement that an insured must give disclosure of material circumstances before the contract is entered into. However, that duty is restated such that the requirement will be fulfilled if an insured either:

1. discloses all material circumstances of which it is, or ought to be aware of, or
2. gives the insurer sufficient information to put a prudent insurer on notice that it should make further enquiries.

It remains to be seen how this will be interpreted by the Courts but, in our view, the second limb should be treated as a 'catch all' rather than a viable alternative. That said, insurers and coverholders should be reviewing underwriting practices and guidelines in light of the new onus on them to make enquiries where presentations raise questions or flag areas where further information is required.

For brokers and insureds, the new law on what must be disclosed to the insurer (what the insured 'knows or ought to know') is one of the more complex parts of the Act. For corporate insureds, what is 'known' means what is known to senior management and/or those responsible for the insurance arrangements. This is broader than simply the insured's board of directors and may include, for example, a general counsel who is not a board member or, in the case of a D&O policy, the individuals covered by that policy.

The Act also makes clear that a 'reasonable search' includes information held within the insured's organisation or 'by any other person', e.g. a broker or external risk manager. It remains uncertain whether the Courts will apply a broader test for the requirement to conduct a 'reasonable search' than under the current law but it should be noted that what is 'reasonable' is likely to depend, inter alia, on the type and size of the risk and geography and company structure of the insured.

What should you be doing now to respond to the changes?

- Consider the scope of the pre-placement searches that will be necessary – who are the relevant persons for the purposes of knowledge, where are the relevant documents held etc? Do you want to seek to agree this with your insurer?
- Reconsider renewal timescales and plan for renewal to take longer.
- Update proposal forms and policy wordings to reflect changes under the Act.
- Consider who holds what information about particular risks and which personnel need to be familiar with any information held by the insurer concerning the risk. Particularly key is the interaction of the claims and underwriting arms.
- Review and revise your underwriting guidelines and how you assess risk.
- Consider the format of the presentation – in particular, you need to ensure that you are not data dumping.

Remedies for breach of the duty of fair presentation

The most wide-ranging reform introduced by the Act is to the remedies available for breach by an insured of the duty to make a fair presentation. The new remedy depends on the nature of the insured's breach. If the insurer can prove that the breach was deliberate or reckless, it can avoid the contract and retain the premium. If not, the remedy will depend on what the insurer would have done had it been fully apprised of the facts:

— If the insurer can prove to the Court's satisfaction that it would not have written the contract on any terms, it can avoid the contract but must return the premium;

— If the insurer would have written the risk but on different terms, it can treat those different terms as applying ab initio; and/or

— If the insurer would have charged additional premium, it can reduce any claims payments accordingly.

Much will depend on what the insurer is able to prove and marks a dramatic shift from the current legal position and one that insurers and brokers need to plan for carefully.

What should you be doing now to respond to the changes?

— Review underwriting tables and guidelines to enable you to evidence what you would have done had you been fully apprised of the facts – i.e. would the risk simply not have met your risk profile or would you have inserted different terms and/or charged additional premium?

Warranties

Despite much controversy, the Insurance Act retains warranties in English insurance law but with three important revisions:

1. The abolition of basis of contract clauses, whereby pre-contractual statements are turned into a warranty by a provision in the policy;
2. Any breach of warranty suspends an insurer's liability until the breach is remedied; and

3. Where the warranty (or other term) relates to a loss of a particular kind or at a particular location or time, there must be a causal link between the loss and the breach of warranty. For example, if the policy contains a warranty that a warehouse will have a fire alarm but no such alarm is installed, the insurer will be able to rely on breach of warranty in respect of a fire loss but not in respect of a flood.

What should you be doing now to respond to the changes?

— Updating proposal forms to remove basis of contract clauses.

— Consider how you are going to evidence and record when a warranty has been breached and when it has been remedied. For example, if a policy contains a warranty that a warehouse will have a working fire alarm and the alarm was out of order for a two-month period, the insured should record the date on which the alarm stopped working and the date it was repaired.

Contracting out

The Act provides a 'default regime' for non-consumer insurance contracts. With the exception of the prohibition of basis of contract clauses, parties to non-consumer contracts can contract out of provisions in the Act. Where insurers intend to opt out and include a 'disadvantageous term', i.e. one that would put the insured in a worse position than they would be in under the Act, the term will have to be clear and unambiguous as to its effect and drawn to the insured's attention before the contract is entered into.

A general opting-out clause is unlikely to be sufficient and insurers will need to draw each disadvantageous term to the insured's attention. However, we doubt that general opting out will be prevalent in the market but opting out of parts of the Act may be of interest to both insurers and insureds.

Where opting out (whether generally or of parts of the Act), insurers and brokers will need to consider what alternative legal position should apply in default of the Act and careful drafting will be needed to achieve the parties' intentions.

What should you be doing now to respond to the changes?

— Consider whether you want to opt out of any part(s) or all of the Act and, if so, what regime you wish to apply.

Enterprise Bill

When it comes into force in 2017, The Enterprise Bill will insert an applied term into all insurance contracts that the insurer must pay claims within a reasonable time. If the insured can prove that an insurer did not comply with this implied term, it will be entitled to damages from the insurer.

Third Party (Rights Against Insurers) Act 2010

The Insurance Act enables the coming into force of the Third Party (Rights Against Insurers) Act 2010 on 1 August 2015. The Act will enable third parties who reasonably believe that an insured is liable to it and is insured to claim directly against the insurer. It will also enable third parties to obtain information about the insured's insurance from anyone who holds it (i.e. insurers and brokers).

This Act will overhaul and simplify third party rights, creating a larger burden on insurers and a new burden on brokers.

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Could the naming of UK storms impact on reinsurance claims?

To what extent would a direct insurer be entitled to aggregate claims arising from more than one named storm, and shift a greater share of its claims to the excess of loss market?

We analyse below some of the legal issues arising from the serious flooding that has affected large parts of the country. For the first time, the Met Office has started to give names to UK storms – with Desmond, Eva and Frank already contributing towards widespread damage, followed by Gertrude and Henry in late January and early February.

The naming of storms brings into focus issues that have previously been thought of as more relevant to natural disasters elsewhere in the world.

The English Courts have traditionally determined questions of reinsurance policy coverage on the basis of a careful scrutiny of the language of the reinsurance contract, and therefore the answers to most, if not all, of these points will lie in the precise words adopted. The clauses applicable can vary significantly from one treaty to another. A soft market often results in a broadening of terms favouring reinsureds.

Aggregation

The trade press has reported that to date, most UK exposures have been retained by direct carriers, with limited claims hitting applicable excess of loss layers. To what extent would direct insurers be entitled to aggregate claims arising from more than one of the named storms, and thereby shift a greater share of the claims to the excess of loss market?

Aggregation language for storm and flood can permit aggregation on one of a number of alternative bases. The starting point will be to seek to identify the event. Usually, a single storm will be regarded as an event, but if more than one storm contributes to flooding the relevant event may be less clear. As a consequence, most event definitions are modified by 'hours' clauses, specifying that all loss or damage occurring within a set period of time is to be aggregated as a single loss. For flood losses, an hours clause will typically specify 168 hours (i.e. seven days). However, flood losses may be ongoing for more than 168 hours and be contributed to by more than one weather event (in this case, more than one named storm). Some event clauses refer specifically to high water marks and address the situation where flood levels recede but then peak again. Increasingly, hours clauses for flooding are being extended to 504 hours (i.e. 21 days), allowing greater scope for aggregation.

Causation

Related to the question of aggregation is the difficulty of ascertaining which event (if there is more than one) was causative of a particular loss or losses. There have been examples over the last few weeks of buildings being damaged first by wind and rain and then by swollen rivers, contributed to by each of the named storms, progressively washing away foundations until the building collapses into the river. Whether or not the damage can be said to have been caused by any of the named storms or (separately) by the flooding will depend on the terms of both the direct policy and the reinsurance.

Loss in Progress

A particular feature of these winter storms is that they will straddle two annual periods for any reinsurances renewed at 1 January 2016. Because the Atlantic hurricane season is generally thought of as running from June to November and the Pacific typhoon season from May to October, the question of losses crossing over from one annual period to the next does not frequently arise in the context of severe weather losses. In some ways, the pattern is more comparable with events such

as the New Zealand earthquakes in 2010 and 2011. In that case, the market generally treated the major earthquakes as four separate events, but for reinsurances with less standard aggregation provisions and Extended Expiration clauses in respect of losses in progress, it was possible to argue that a single loss event had started in 2010 and was still ongoing in 2011. Similarly, a combination of a 504 hours clause and an Extended Expiration clause might allow a reinsured exposed to flooding losses commencing in December 2015 to aggregate with damage occurring in 2016.

Sole Judge

One of the most advantageous clauses for a reinsured is a 'sole judge' clause permitting the reinsured to determine for itself when a loss event starts and finishes. Sole judge clauses vary from reinsurance to reinsurance, but one example that may be extremely useful to a reinsured is a clause that allows the reinsured as sole judge to specify the start point of the 168 hour period.

Contingent Business Interruption

The scale of the flooding increases the likelihood of claims being brought by commercial policyholders as a consequence of interruption to their businesses, even if their premises have suffered no physical damage. Even if policyholders do not currently purchase contingent business interruption (CBI) protection, the recognition of CBI exposures coupled with the soft market conditions may encourage a much higher uptake of CBI coverage going forward. Reinsurance policies frequently do not cover CBI losses, which are notoriously difficult to rate.

Flood Re

The current UK floods are likely to be the last major flood event affecting the UK before the introduction of the government-backed reinsurer Flood Re. Having secured GBP 1.29bn worth of reinsurance cover, Flood Re remains 'on track' and should accept its first policy in April 2016 as planned, according to Brendan McCafferty, CEO of Flood Re. The scheme, now in light of recent events more relevant than ever, will enable households in areas of high flood risk to obtain affordable insurance cover.

Once established, Flood Re will cap flood insurance premiums for householders at a level based on the council tax band of domestic properties. Claims made by people in homes at high risk of flooding will be funded through an industry-backed levy, to be passed back to consumers at an estimated cost of GBP 10.50 on annual premiums and so their premiums next year will be subsidised. Flood Re's systems have been built and testing has begun with the insurance industry. It therefore seems unlikely that even the record flooding experienced over recent weeks will knock the Flood Re scheme off course.

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Insurance – economic sanctions against Iran

The lure of a new market worth potentially USD 7.4bn in gross premium[1] should come with a health warning for insurers and brokers.

On 16 January 2016 EU sanctions against Iran were eased under the terms of the Joint Comprehensive Plan of Action (JCPOA) agreed by the E3 + 3 (UK, France Germany, US, Russia and China) and Iran last July. This date is formally known as 'Implementation Day' and is the date on which the International Atomic Energy Authority confirmed to the UN Security Council that Iran had complied with the programme set out in the JCPOA.

Implementation Day has been long awaited by interested parties across the globe, particularly European and Asian investors. Iran boasts a young, highly educated and sophisticated population of some 80 million people. Rarely does a large and diversified economy such as Iran's open up overnight.

Lifting of insurance-related sanctions

Amongst those sanctions that have been lifted is the EU embargo against the provision of insurance to Iranian entities. EU insurers are now permitted to provide insurance and reinsurance to non-listed Iranian entities.

[1] Source: Insurance Journal

Lloyd's has issued a Market Bulletin confirming that the (re)insurance of Iranian petroleum and oil products is now allowed. The direction in the Market Bulletin issued by Lloyds on 8 July 2010 (Y4409), requiring managing agents to ensure that no contract of (re)insurance was entered into, amended and/or endorsed, where they knew or ought to have known, that an Iranian Refined Petroleum Risk would be (re)insured under the contract, is therefore rescinded.

However, it should be noted that sanctions have not been completely lifted in relation to Iran and a number of restrictive measures remain in place against persons/ entities and in relation to particular sectors, principally relating to military goods and nuclear-related goods. There will still remain in place a list of designated persons with whom it will be prohibited to deal.

The lifting of sanctions presents opportunities but not without risk

The relaxation of sanctions against Iran opens up opportunities in a potentially significant market for London Market (re)insurers. With the reported potential premium income available it's perhaps unsurprising that the easing of sanctions has led to insurers reportedly expressing interest in opportunities to enter the market.

Underwriters and brokers are well-advised to tread carefully, however, in view of the sanctions which remain in place – most notably sanctions imposed by the US, with US companies (including UK subsidiaries of US corporates) remaining broadly prohibited from engaging in transactions involving Iran.

EU companies which are owned or controlled by US corporations will fall under US jurisdiction and will therefore continue to be subject to US primary sanctions. However, the U.S. Treasury Department's Office of Foreign Assets Control (OFAC), through their issuing of General License H, authorises non-US entities to engage in business with Iran, subject to certain exemptions and restrictions including strict limitation on the extent of involvement of the parent company.

The US has also eased sanctions on Iran in respect of the oil and shipping sector. However the easing of such sanctions principally targets non-US persons conducting business with Iran and save for limited exceptions, the general trade embargo remains in place for US companies.

The potential for 'snap-back'

A further risk for insurers and brokers alike to consider is the possibility that Iran violates its undertakings in the JCPOA. In such a case the EU has reserved the right to re-impose sanctions on Iran – the so-called 'snapback' provisions. Insurers who have contracted with Iranian companies may therefore find themselves bound by insurance contracts which they cannot perform.

Recommendations

Insurers and brokers should continue to consider, in particular, if proposed dealings are with a designated person or entity, and how and to whom payments will be made. Insurers and brokers will also want to consider whether their proposed activity is subject to US sanctions as a result of a commercial arrangement having a nexus with a US person or company. It therefore remains important to ensure appropriate due diligence measures are undertaken before engaging in any activity in Iran or with Iranian entities.

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Relocation of headquarters – some of the things to think about

This type of relocation is a major project. It is something that happens only once every 10-20 years and is an opportunity for a business to re-examine the way it works and the way it plans to operate in the future. Potential tenants will rely on experienced surveyors and lawyers to help negotiate the commercial deal and the subsequent detailed documents.

There are a range of issues that a tenant needs to consider as part of any relocation project. To take just a few examples:

1. If the tenant is moving into a multi-let building there will be service charge arrangements. At a basic level a tenant should make sure that the service charge covers normal operating costs and not other expenditure which should really be the responsibility of the landlord or the developer. This is particularly the case in the context of any new building. Service charge clauses will often be widely drafted and a tenant could find, for example, that it is liable to pay via the service charge for the cost of repairing an inherent defect in a new building unless the lease excludes this cost. Similarly, in more complex buildings, there may be quite an extensive range of services. Tenants should where possible negotiate service charge caps so as to limit their liability at least for the first few years of the lease and achieve budgeting certainty.
2. If a tenant is taking more than one floor in a building, it should consider taking separate leases of the individual floors instead. This will give greater flexibility when it comes to alienation (each lease can be assigned separately). No tenant ever enters into a lease of a new building assuming it is going to assign or otherwise dispose of its interests during the term, but in practice many will do and a tenant needs to make sure that there is as much flexibility as possible.
3. Always be conscious of the date of expiry of any existing lease. It is essential to check whether a tenant has the benefit of protection under the Landlord and Tenant Act 1954 because this will give the tenant the ability to hold over or extend its lease at the end of the term if, for example, the new space is not ready on time. This is particularly an issue in relation to new build properties or where there are extensive tenant fitting out works. Tenants who run out of time in relation to their existing premises may simply find themselves ransomed by a current landlord all for the sake of a few months' extension.
4. Remember to consider dilapidations liability in relation to existing premises, i.e. a tenant may be liable to put the property back in a good state of repair as well as removing all of their alterations. This can be both time-consuming and expensive and the need to deal with potential dilapidations liability needs to be factored into any building programme for fitting out works so that the necessary reinstatement works can be carried out prior to the expiry of the lease of the current premises.

These are just a few of the basic issues to consider. There are a whole range of others. As with most things the key is proper planning and negotiation and employing the right consultants (whether legal, surveyors or fit-out consultants), to ensure that a tenant's interests are properly protected.

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Market moves – Protect yourself or risk losing in game of musical chairs

It seems an eternity ago when a member of the insurance/reinsurance market would join an established firm and remain there for an entire working life. Barely a week goes by when we don't read of a notable move involving senior executives or business units, taking with them valuable client connections and often profitable business streams.

This game of musical chairs frequently has significant international and cross-border impact. Inelegant choreography by either side can cost a fortune, particularly when it is publicly played out in a glare of publicity and social media gossip.

Of course, there are housekeeping measures that can smooth the process, with the starting point in securing moves or protecting significant revenue streams being a review of the contracts of all key employees.

Invariably provisions will protect confidential information and client lists; commonplace are restrictive covenants, preventing competition or solicitation of clients or employees for a limited period. These covenants must be kept up-to-date to reflect the constantly developing law on enforceability.

The ability to place employees on gardening leave – and to get orders enforcing such requirements, if need be – can be crucial in protecting the business. This requires suitable contractual provision. Less common, but potentially helpful in establishing a breach by a business leader or other employee, is a clause requiring the reporting of any approaches by a competitor or potential new employer or indeed by a colleague – the English Courts have recently upheld the validity of such a clause in an insurance scenario.

As soon as a business crosses the line where it can be said that it has induced any unlawful actions by members of a target team, damages – and accounts of profits – and injunctions follow. In the UK, if those moving are striving to gain some improper competitive advantage for a rival employer, the English Courts can issue springboard injunctions – orders preventing wrongful use of confidential information to those seeking to get a head start in new business ventures – levelling the playing field by imposing restrictions going beyond the employees' contracts.

These cases increasingly take on a cross-border character. There is a legal minefield for any party to navigate; get it wrong and the business move does not happen, or comes with an unexpected Premier League-style transfer fee, all played out amidst the media spotlight.

During August 2015, CMS advised on enforcing in England restrictive covenants contained in Bermuda employment contracts. With a London market or other English dimension, covenants will have to pass legal muster under foreign (in this case Bermudan) and English laws. In the international insurance or reinsurance marketplace, absolutely key is whether teams or individuals have contracts subject to the law of the likely place of enforcement.

When properly planned, team or other business moves can happen with a minimum adverse legal consequences but there are a lot of moving parts to consider. Overreaction by a business to its potential departures can be as detrimental as careless dealing and contact by the proposed acquirer.

Another recent example from our own case load involved a team move where a springboard injunction was later set aside by the English Court with a full opponent costs order payable.

It transpired that the injunction had never been justified by the evidence and full and frank disclosure of all relevant facts had not been given. In this area, careless dance moves cost a fortune.

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2016 was expected to bring a number of fundamental changes to the pensions industry – has it lived up to expectations so far?

The Pensions industry was gearing up towards a number of fundamental changes at the beginning of 2016 – hares were racing at the possibility of future changes to pension taxation, whilst the words 'contracting-out', 'VAT' and 'de-risking' were frequent topics of conversation. This article looks at some of the changes which have taken place so far, and highlights those that are still to come.

Budget 2016

Until early March, it had been widely anticipated that seismic changes would be announced to the pensions tax landscape. However, in the weeks prior to the Budget, it became clear that the Chancellor had decided to leave pensions largely alone this time around – it is not clear whether such reform has been shelved or if it will be resurrected at a future date when the Government is not facing an EU referendum.

A number of changes to the pension tax rules have been made to ensure they operate as intended following the introduction of the pensions flexibility in 2015, which although fairly insignificant may impact on benefits that schemes pay out. The Budget also saw the introduction of the new Lifetime ISA, which has been criticised for undermining the objectives of auto-enrolment, as it is thought it may lead to an increased number of lower earners opting-out.

Single-tier state pension/end of contracting-out

6 April 2016 saw the introduction of the single tier state pension, which replaced the existing basic and earnings-related state second pension for individuals reaching state pension age on or after 6 April 2016. As a consequence of the abolition of the state second pension, defined benefit contracting-out also ended on 5 April 2016.

For pension schemes that were contracted-out and open to accrual prior to 6 April 2016, the end of contracting-out meant that both members and employers would pay higher, standard rate (Class 1) National Insurance contributions. For employers, this represents an increase from 10.4% to 13.8% of earnings within the same banding. In monetary terms, this could equate to up to GBP 1,163 per employee, per year.

Although consideration will most likely have already been given to any necessary changes to pension scheme documentation, it is worth noting that trustees of pension schemes still have the power to pass a resolution to allow open schemes to provide for fixed rate revaluation to apply from the end of pensionable service, rather than 6 April 2016. The power to pass such a resolution will expire on 6 April 2017.

Auto-enrolment

In 2016 up to 500,000 UK employers will start their workplace pension duties. If your pension scheme is not already compliant with auto-enrolment, you will need to determine your staging date and start preparing.

The Pensions Regulator has enforcement powers in place; however, where employers have not complied with auto-enrolment duties because of a lack of understanding, the Pensions Regulator will work with them to help them become compliant. Where employers have complied with the spirit of the law, but committed procedural mistakes, the Pensions Regulator will consider whether a breach has occurred deliberately or not and reflect this in the approach it takes.

VAT Recovery

Employers are currently able to recover VAT charged on all fees for services provided to trustees of the employer's pension scheme, other than the majority of fees for investment management services.

However, HM Revenue and Customs' approach to recovery of VAT is changing following the decision of the European Court in the PPG case. Whilst the decision said that an employer could recover VAT on investment fees (which was not previously permitted by HMRC), the decision has led HMRC to review the arrangements for recovery of VAT on all pension costs.

Until now, there was usually no need for trustees to register for VAT or become part of the employer's VAT group. It was sufficient for an employer to receive an invoice for services provided to the trustees and the employer could recover the VAT on that invoice even if the fees themselves were paid by or recharged to the scheme. This applied to all services other than investment management fees; VAT on the fees attributable to management of investments could not be recovered by the employer.

In light of the PPG decision, HMRC now says that the previous arrangements do not work because employers must actually receive the benefit of any service, and pay for those services, in order to recover the VAT.

This means that employers face losing the ability to recover VAT on any services of the pension scheme, causing their pension costs to go up yet again.

Schemes and employers need to meet the new requirements by January 2017, however there continues to be much uncertainty about what schemes and employers can do to allow VAT to be recovered under the new regime. Employers may wish to continue their existing arrangements and wait for future HMRC guidance before deciding how to deal with this issue.

De-risking

2016 could be a good year for employers to consider de-risking their defined benefit pension schemes as favourable prices are on offer due to increased capacity in the (re)insurance market.

The pensions risk transfer market has seen substantial innovation and expansion over recent years. In particular, 2015 saw an increase in 'top slicing' – these transactions focus on a pension scheme reducing its longevity risk by completing medically underwritten bulk annuities in respect of its 'top slice' of members who represent a higher proportion of liabilities. Members of the scheme are asked to provide details of their health (which has seen a surprisingly high response rate), generally resulting in more favourable pricing for such transactions. It is likely that 2016 will see further growth in this area, however with the two main players in the market set to merge, pricing may be affected.

The insurance-based longevity market is also forecast to see increased activity in 2016, with transactions now incorporating deferred members (rather than just pensioners), and opportunities opening up for medium/smaller sized pension schemes.

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Judgment from start to finish in 10 months: new High Court procedures, if...

Two pilot schemes providing shorter and more flexible litigation procedures have been introduced for claims issued in the High Court in London, running from 1 October 2015 until 30 September 2017. The Schemes aim to reduce the time and costs incurred by parties to litigation and provide a mid-point between the 'rough justice' of adjudication and full-blown litigation.

The new Shorter and Flexible Trials Pilot Schemes are available under the new Civil Procedure Practice Direction 51N. They can be applied to any claim issued in the Rolls Building, London (i.e. the Commercial Court, Technology and Construction Court, London Mercantile Court and the Chancery Division) subject to the specific limitations on the Shorter Trials Scheme noted below.

Background

The Schemes are a result of an investigation by a committee of Rolls Building Courts' judges and legal practitioners into procedures that could be adopted in order to achieve shorter and earlier trials. The draft Practice Direction was the subject of a public consultation in May 2015.

The aim of both Schemes is to 'achieve shorter and earlier trials for business-related litigation, at a reasonable and proportionate cost' with the recognition that comprehensive disclosure and a full, oral trial on all issues is often not necessary for justice to be achieved. Certainly both Schemes should allow disputes to be resolved within a more commercially attractive timetable than is normally available in the Courts.

The Shorter Trials Scheme ('STS')

The STS offers judgment within a year of the issue of proceedings through a revised, streamlined procedure. Aimed at straightforward cases, it is not suitable for those involving allegations of fraud, extensive disclosure, extensive witness/expert evidence, or complex cases with multiple issues or parties.

In summary:

— Parties can issue cases directly onto the STS, or transfer existing cases across (provided that they are issued on or after 1 October 2015).

— The STS is not mandatory and whether the case is suitable for the STS is at the Court's discretion.

— Scope for parties to extend the timetable is limited.

— A simplified pre-action procedure replaces any otherwise applicable pre-action protocols.

— The length of statements of case, witness statements and expert reports are restricted (for example, a maximum of 20 pages for the Particulars of Claim).

— All proceedings will be heard by the designated judge as far as possible to reduce reading in time.

— Applications will generally be dealt with on paper.

— Disclosure is limited to documents relied upon or specifically requested.

— Trial length is restricted to four days (including reading time) and cross-examination is restricted.

— Costs budgeting will not apply unless otherwise agreed.

The Flexible Trials Scheme ('FTS')

The FTS enables the parties to agree a flexible, simplified and expedited case management procedure, with the aim of reducing costs and obtaining an earlier trial date.

In summary:

- Claims are issued as normal and parties agree the use of the FTS prior to the first Case Management Conference (CMC).
- Once the use of the FTS is agreed, certain streamlined directions apply (subject to any modifications agreed by the parties) unless the Court considers there to be a good reason why they should not.
- Disclosure is restricted, although it is wider than in the STS.
- Oral evidence at trial is limited to identified issues or witnesses, as directed at the CMC or agreed between the parties.
- Submissions at trial are generally made in writing, with oral submissions and any cross-examination to be subject to time limits decided at the CMC or agreed between the parties.

Impact and implications

The Schemes aim to provide a heavily streamlined Court procedure applicable for certain types of cases. Schemes will need to determine at an early stage whether their dispute is simple enough to be suitable, which may prove difficult in some circumstances. The Schemes are also reliant on the Court having sufficient capacity to hear claims within the expedited time period.

The nature of the Schemes and the ability to abridge the procedural process is really striking. Unsuspecting defendants will need to be aware of short turnaround times for protocol responses and defences and the need for an early raising of any objection to the applicability of the Schemes. Any such application will need to be made in advance of the first CMC.

The FTS provides a slightly lower level of streamlining applicable to all cases, focusing mainly on reductions in disclosure and the shortening of trial lengths by the reduction in oral evidence and submissions and no doubt will be looked on favourably by the managing Judge(s).

If there is a dispute between the parties about whether more extensive evidence than what the Schemes envisage is needed, then contested applications to oust the Schemes' applicability to a claim will inevitably result. For those cases that, by their nature, are apt for determination within the Schemes, the Court driven target of hearing and written judgment within 10 months of issue is really attractive. What will be determinative to the implementation of the Schemes is the appetite of the Courts for a speedier and more streamlined dispute process than the STS in particular now offers – watch this space.

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Insurance Distribution Directive adopted – implementation for 2018

On 14th December 2015, the Council of the EU adopted the Insurance Distribution Directive ((EU) 2016/97) (IDD). The implementation deadline for Member States is 23 February 2018 (with transitional provisions for intermediaries registered under the Insurance Mediation Directive (IMD) until 23 February 2019[1]).

Overview and key changes

IDD leaves Member States the option to impose additional requirements in many areas and so can be regarded as a **minimum harmonising** directive (like IMD). IDD will be a much more substantial regime and will include further level 2/3 material (as explained below).

Cross-sectoral consistency has been an issue and there is a complicated relationship with other EU legislation (Solvency II Directive (2009/138/EC), MiFID II Directive (2014/65/EU), IMD (2002/92/EC) and PRIIPs (Regulation (EU) No 1286/2014) – as explained further below.

MiFID II amends IMD to introduce, for insurance-based investment products, certain elements of the COB rules under MiFID (new Article 13(a) to (e) of IMD). With the delay to MiFID II implementation (read our earlier RegZone report on this topic here), it seems that these changes may now be superseded by IDD.

The scope of IDD is broader than that of IMD:

— It has been extended to all sellers of insurance products (insurance distributors), including insurers/reinsurers that sell directly to clients (Chapter I).

— Some mere 'introducers' will no longer be caught (Article 2 (2) (c)).

— IDD also captures certain activities conducted via price comparison/aggregator websites (Article 2).

Other key changes to the pre-existing IMD-regime are briefly discussed below:

— **Information and conduct of business (Chapters V and VI).** This is an area in which cross-sectoral consistency has been an issue. For example IDD requires distributors to 'always act honestly, fairly and professionally in accordance with the best interests of their customers' (like MiFID). Advice is not mandatory under IDD but Member States are free to impose such a requirement. There are additional requirements for insurance-based investment products including enhanced provisions concerning conflicts of interest.

— **Conflicts of interest and remuneration (Recital 40 and 41; Article 18 and 19).** There are general requirements to prevent remuneration causing a conflict of interest or distorting recommendations.

The Commission's original IMD II proposal required mandatory (i.e. not only 'on request') prior disclosure of the amount of commission earnt by insurance brokers/intermediaries. This was highly controversial and has not survived into the final text of IDD (see our May 2014 report). IDD requires intermediaries to disclose the type/nature of their remuneration (fee paid by client, commission or other forms or a mix of these).
The amount of any fees must be disclosed (but not the amount of any commission).

[1] Article 40, IDD.

Member States, however, will be free to impose more onerous disclosure requirements, or to restrict or prohibit commission payments.

IDD also requires insurers to disclose the nature of the remuneration received by its employees.

The additional obligations applicable to **insurance-based investment products** (Chapter VI) include additional requirements in relation to conflicts of interest, disclosure and remuneration/third-party payments (reflecting cross-sectoral consistency with MiFID).[2] It expressly permits Member States to impose stricter requirements, for example, prohibiting fees, commissions and non-monetary benefits from third parties in the context of insurance advice. This would allow Member States to impose the full MiFID II regime prohibiting third-party payments in relation to those giving independent advice.

— **Standard insurance product information document (Article 20).** For general/non-life products, IDD requires the use of a standard format for pre-contract product information disclosure. For insurance-based investment products a Key Information Document (KID) will be required under PRIIPs.

— **Professional knowledge and competence requirements (Recital 28; Article 10; Annex I).** Provisions in the directive emphasise the need for appropriate levels of product knowledge given their complexity and the nature of activities conducted. There is a requirement for continuous professional development/training based around 15 hours per year. Member States may require successful completion is proven by obtaining a certificate.

— **Cross-border passporting (Article 3(4); Chapter III).** IDD clarifies the procedure for cross-border entry by intermediaries into insurance markets in the EU. EIOPA is to establish a single electronic register containing records of insurance, reinsurance and ancillary insurance intermediaries which have notified their intention to carry on cross-border business in accordance with Chapter III of the directive.

— **Bundled products (Article 24).** IDD introduces disclosure requirements where suppliers cross-sell/bundle products together. The onus is on the supplier to inform the customer if it is possible to buy the product(s) separately.

— **Product governance (Article 25).** A product approval process is required, for each insurance product, to consider the risks for the target market (see further below).

— **Sanctions (Chapter VII).** IDD increases the level of harmonisation of administrative sanctions and other measures for breach of provisions under the directive.

Product governance – by insurers and intermediaries

On 30 October 2015, EIOPA launched a consultation paper (EIOPA-CP-15/008) on revised proposals for preparatory guidelines **on product oversight and governance arrangements** by insurance undertakings and insurance distributors (POG guidelines). This followed an earlier consultation paper (EIOPA-CP-14/150) on this topic that related solely to insurers under Solvency II. The deadline for responses to the consultation was **29 January 2016**.

There are two sets of guidelines; one for 'manufacturers' (insurer or intermediary) and one for insurance distributors who distribute without manufacturing.

Further to the October 2015 consultation, EIOPA published its final report in April 2016. The aim of the final report is to ensure Member States' competent authorities take a consistent approach in the period before IDD implementation. EIOPA has stated that the POG guidelines form early guidance ahead of technical advice on Level 2 measures for the Commission.

[2] By way of background information on policy development, please see EIOPA's earlier consultation and final report on 'Conflicts of Interest in direct and intermediated sales of insurance-based investments products' (which arose in the context of the MiFID II amendments to IMD –see above).

Level 2 (2016/17)

The Commission is able to adopt **delegated acts** concerning:

- Article 25, which covers product oversight and governance requirements
- Article 28, which covers conflicts of interest
- Article 29, which covers the provision of information to customers
- Article 30, which covers the assessment of suitability and appropriateness, and reporting to customers

The Commission together with EIOPA is to produce **technical standards** (in the form of regulations):

- RTS relating to changes in the European Index of Consumer Prices, under Article 10(7)
- ITS relating to a standard format for the insurance product information document (PID), under Article 20

In January, EIOPA launched an online survey to prepare for the Commission's call for advice on the delegated acts (stakeholders' responses are accessible here). Given concerns over cross-sectoral consistency with MiFID II, the Commission has asked EIOPA to liaise closely with ESMA in the preparation of its Advice.

Level 3 (2016/17)

Provisions have been made for EIOPA to produce **guidelines** concerning:

- Article 17, which covers cross-selling
- Article 30(7), which covers the assessment of suitability and appropriateness, and reporting to customers

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New era for EU Data Privacy Regulation

Businesses of all kinds in the EU and beyond will be affected by the General Data Protection Regulation (**GDPR**)[1], which was given final approval by the European Parliament in April 2016.

Having been published in the Official Journal of the European Union earlier this month the GDPR will apply from 25 May 2018 (and the associated Directives[2] from 5 May 2018). As it will be directly applicable in all Member States, the GDPR will replace the current EU Data Protection Directive (Directive) and its local implementing legislation in Member States. In the UK that means the Data Protection Act will be repealed.

Jan Philipp Albrecht, who steered the legislation through the EU Parliament said: 'The regulation will create clarity for businesses by establishing a single law across the EU. The new law creates confidence, legal certainty and fairer competition'.

[1] Regulation (EU) 2016/679 of the European Parliament and of the Council of 27 April 2016 on the protection of natural persons with regard to the processing of personal data and on the free movement of such data, and repealing Directive 95/46/EC (General Data Protection Regulation).

[2] Directive (EU) 2016/680 of the European Parliament and of the Council of 27 April 2016 on the protection of natural persons with regard to the processing of personal data by competent authorities for the purposes of the prevention, investigation, detection or prosecution of criminal offences or the execution of criminal penalties, and on the free movement of such data, and repealing Council Framework Decision 2008/977/JHA and Directive (EU) 2016/681 of the European Parliament and of the Council of 27 April 2016 on the use of passenger name record (PNR) data for the prevention, detection, investigation and prosecution of terrorist offences and serious crime.

The new law includes:

- a right to be forgotten
- 'clear and affirmative consent' to the processing of private data by the person concerned
- a right to transfer your data to another service provider
- the right to know when your data has been hacked
- ensuring that privacy policies are explained in clear and understandable language
- stronger enforcement powers and fines of up to 4% of firms' total worldwide annual turnover, as a deterrent to breaking the rules.

For many firms there will be a need to ensure that they and their service providers 'up their game' in terms of compliance; for others, such as those offering cyber-security products, the new law will also present a business opportunity.

Firms subject to Solvency II will need to ensure that their service contracts are compliant with the GDPR as part of Solvency II compliance. Solvency II requires service contracts for critical or important services to include obligations on service providers to comply with applicable laws and firm policies. Failure to have the required terms, monitoring and governance measures in place risks incurring fines and censure from the FCA and PRA, as well as the Information Commissioner's Office (ICO) or other competent data protection regulator.

The ability of data protection regulators to impose fines of up to 4% of worldwide turnover, together with the increased public awareness and concern around data privacy issues, means data protection and security should be high on the agenda for businesses at all levels – from product design to IT, customer relationship management and operations.

Whats's new

Transparency and information requirements to data subjects are increased, although the GDPR also looks to take a pragmatic approach to the giving of consent for processing, acknowledging that consent may be given by ticking a box on a website or choosing particular technical settings. Firms will need to review their uses of data to ensure that they have all necessary consents (or that the other conditions for processing are met) and their customer terms and communications to ensure that they are providing all of the necessary information clearly and intelligibly.

Where personal data is processed for more than one purpose on the basis of the data subject's consent, consent for each such purpose must be given. It is likely that terms and conditions and customer communications will need to be revisited to ensure that they are providing the right information, in the correct form and, where specific consent is required for processing, that the route to consent is clear and meets the conditions in the GDPR.

Data subjects will have the right to withdraw consent for processing at any time without detriment. This will not affect processing up to the time consent is withdrawn, or processing that is carried out on other grounds, such as in order to perform a contract or for the legitimate interest of the controller.

The GDPR requires measures to be taken to implement privacy by default and design, and pseudonymisation[3] of personal data as ways of protecting and securing it. The GDPR defines privacy by design as producers of products, services and applications taking into account the right to data protection when developing and designing them and making sure, having due regard to the state of the art, that controllers and processors are able to fulfil their data protection obligations. This will be key in respect of the design of new products and the customer journey in respect of their sale and administration.

Pseudonymisation is mandatory where personal data is being used for scientific or statistical purposes. Profiling and automated decision-making are also subject to new regulation. Individuals must have the right not to be subject to profiling or to decision-making based solely on automated processing, unless such decision-making is necessary for a contract between the individual and the data controller, in which case measures are required to safeguard the individual's rights and they must have a right to obtain human intervention and contest the decision.

Transfers of data outside of the EU are further regulated. Individuals must be given specific information as to whether and where their data will be transferred and the protective measures in place. If a transfer is to a country that has not been deemed adequate by the Commission (and the list of 'adequate' countries remains a very short one) only standard contractual safeguards may be used or a specific authorisation from the ICO (or other competent regulator) will be required. Businesses will need to review their data flows and assess what safeguards are in place with the overseas recipients.

It remains to be seen whether or not the proposed EU – US Privacy Shield[4] will be accepted as an appropriate basis for data transfers to the US in place of the now defunct safe harbour regime. Binding Corporate Rules remain an option and the process for putting them in place is now set out in the GDPR.

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[3] Pseudonymisation means the processing of personal data in such a way that the data can no longer be attributed to a specific data subject without the use of additional information, as long as such additional information is kept separately and subject to technical and organisational measures to ensure non-attribution. Pseudonymised data is therefore still personal data, but using it in this way goes some way to show compliance with requirements for security and protection of personal data.

[4] See the European Commission announcement 'Restoring trust in transatlantic data flows through strong safeguards: European Commission presents EU-U.S. Privacy Shield' at: http://europa.eu/rapid/press-release_IP-16-433_en.htm

The GDPR introduces the possibility of a particular territory or sector within a country being recognised as adequate, and of industry sectors or organisations putting in place agreed codes of practice and certification regimes that would support safeguards for international transfers and protection of personal data more generally. The insurance industry and service providers to it should be looking at these opportunities for standardisation to facilitate good practice and customer confidence, as well as ease the burden of compliance.

Data processors will have direct responsibilities for the first time under the GDPR, and data subjects are to have rights against processors directly in a number of situations so service providers to data controller will be at risk of regulatory sanctions and actions from affected individuals, as well as contractual liability to the data controller.

The ICO will remain the supervisory authority for the UK but will have greater powers of investigation and enforcement, including the right to impose fines of up to 4% of worldwide turnover in the preceding year.

International Operations

Organisations operating in more than one EU member state will need to consider the location where the decisions are taken as to the purposes and means of their processing of personal data are taken, as it will be the supervisory authority in that country that will be their 'lead authority' with competence to oversee their compliance. It remains to be seen how this new structure will work in practice as local regulators will still have competence to deal with complaints and infringements that arise in their country.

Businesses that are not physically present in the EU but offer goods or services to or monitor the behaviour of EU residents will be subject to the GDPR. Unless the processing of personal data that they carry out is small scale, occasional, does not involve special categories[5] of personal data and is unlikely to pose a risk to the rights and freedoms of data subjects, they will be required to appoint a representative in a member state as a contact point for the data protection regulators.

Conclusion

This is a just a flavour of some of the measures that the GDPR will introduce or change, so look out for further updates from us. The intention of the GDPR is to bring consistency across the EU, where member states have had diverging applications of the current Directive. This at least could benefit businesses with cross-border interests in the EU.

There is work to be done by businesses before the GDPR comes into effect and, with the emphasis on privacy by design, this will not just be a job for compliance and legal teams.

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[5] Data which reveals racial or ethnic origin, political opinions, religious or philosophical beliefs, trade union membership, genetic and biometric data, and data concerning health, sex life or sexual orientation. This is slightly changed from the concept of 'sensitive personal data' under the existing Directive and the Data Protection Act.

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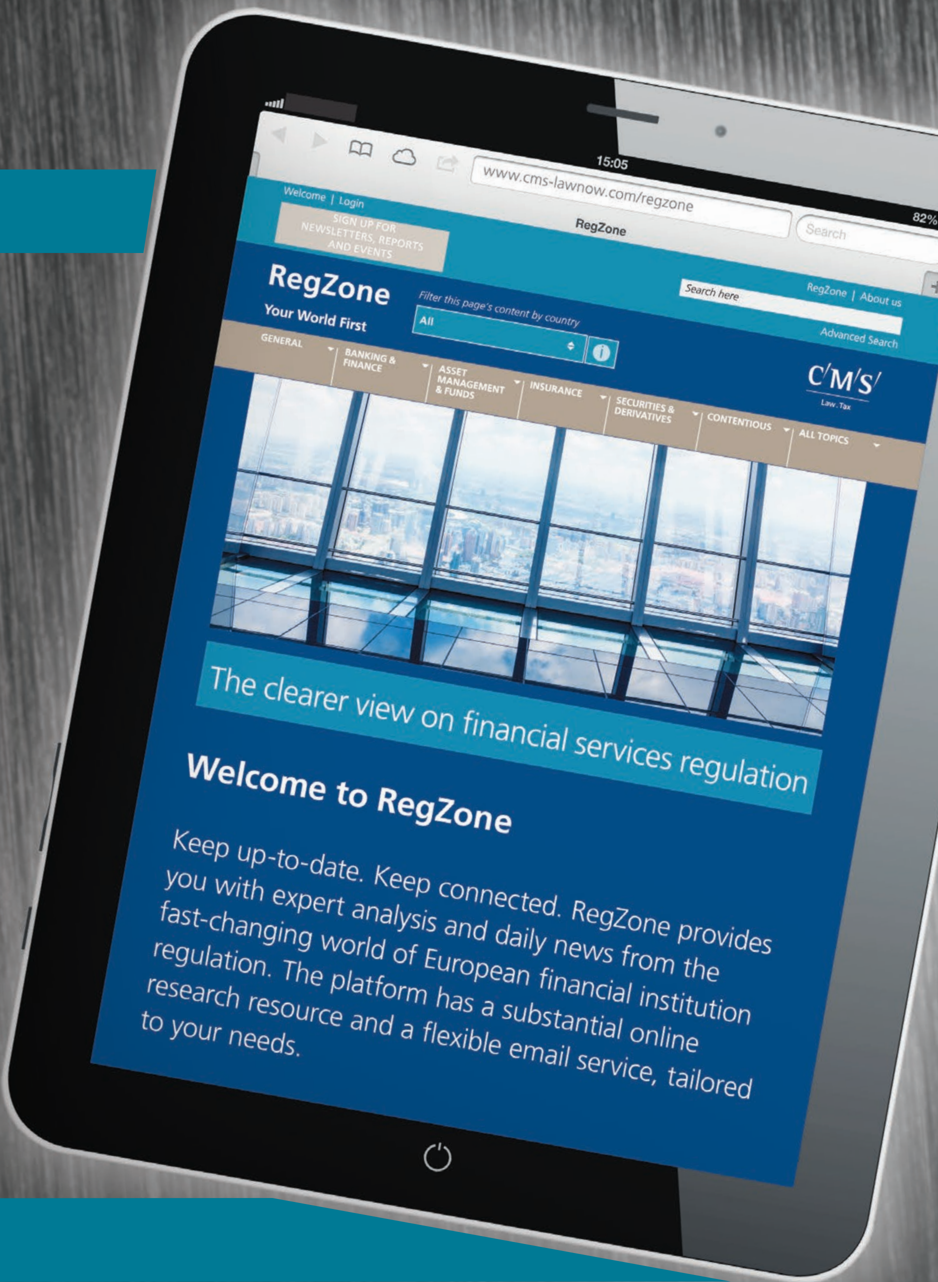

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