CLIFFORD CHANCE

Insurance Global – Autumn 2016

Introduction

Welcome to our Insurance Global publication which outlines global legal developments in the insurance and reinsurance sector in 2016.

This year, the global insurance sector has experienced both certainty, following the implementation of Solvency requirements in the EU and in China, and uncertainty, in the UK in particular, following the political and market uncertainty generated by the Referendum vote to leave the EU ("Brexit"). In this publication, we look closely at legal developments in specific jurisdictions and highlight possible future growth opportunities, for example, for foreign investment in the Chinese insurance Fintech sector and in the US following capital reduction permissible under US Basel III Rules.

In such unpredictable times, Clifford Chance is well placed to anticipate and translate legal developments for its insurance clients. International offices in over twenty different countries also enable Clifford Chance to provide exceptional solutions to an increasingly global insurance market, whilst also being able to deliver localised legal advice where needed. This further demonstrates Clifford Chance's ability to provide outstanding and precise solutions for both our local and international clients.

This edition highlights developments in the European sphere, predominately following the implementation of Solvency II, and on the global stage with legal updates from China, Germany, Italy, Luxembourg, Spain, the UAE, the UK and the US.

If you require further information in any particular jurisdiction, please do not hesitate to get in touch – the contact details may be found on the global contacts page on this publication.

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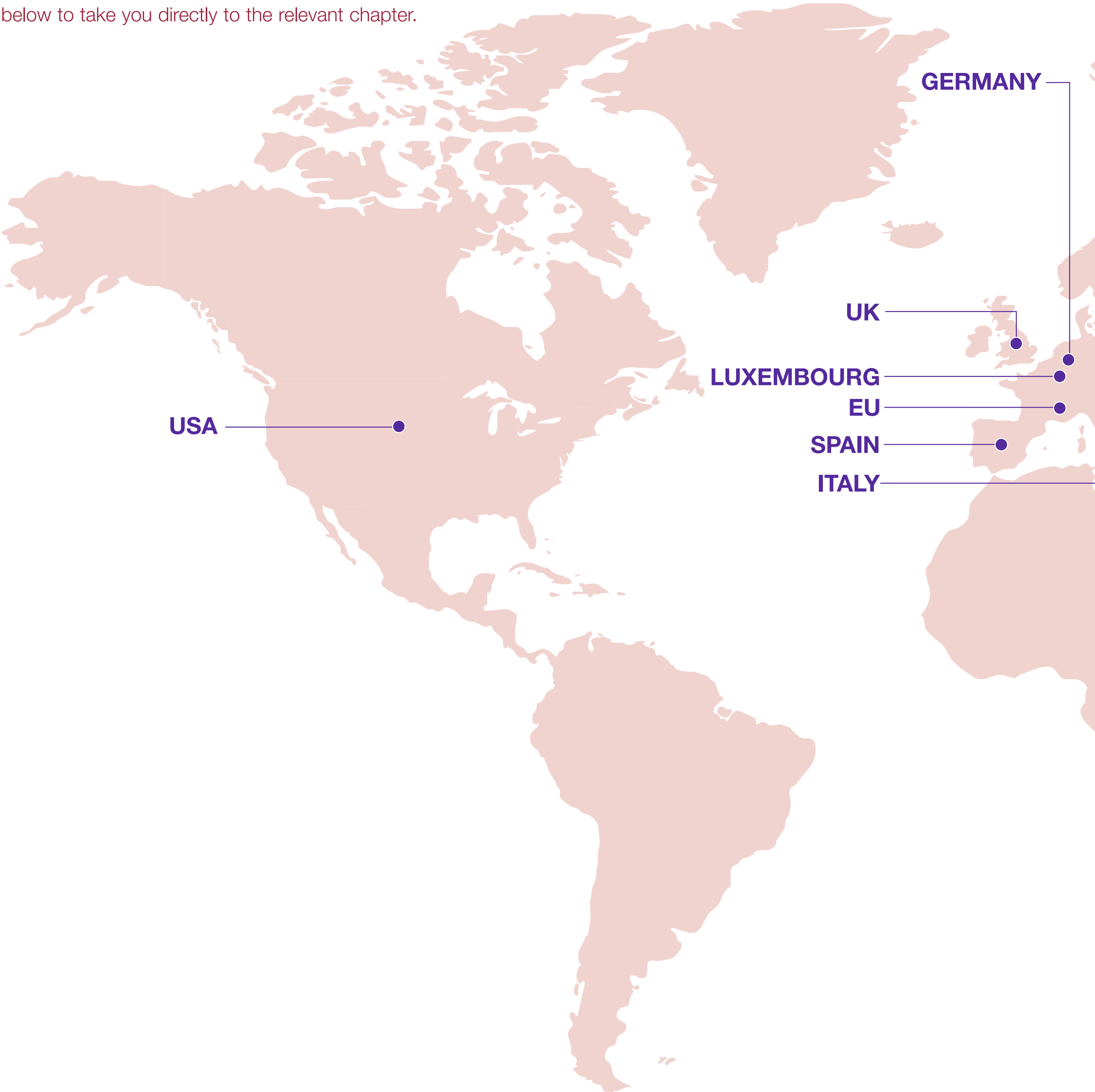
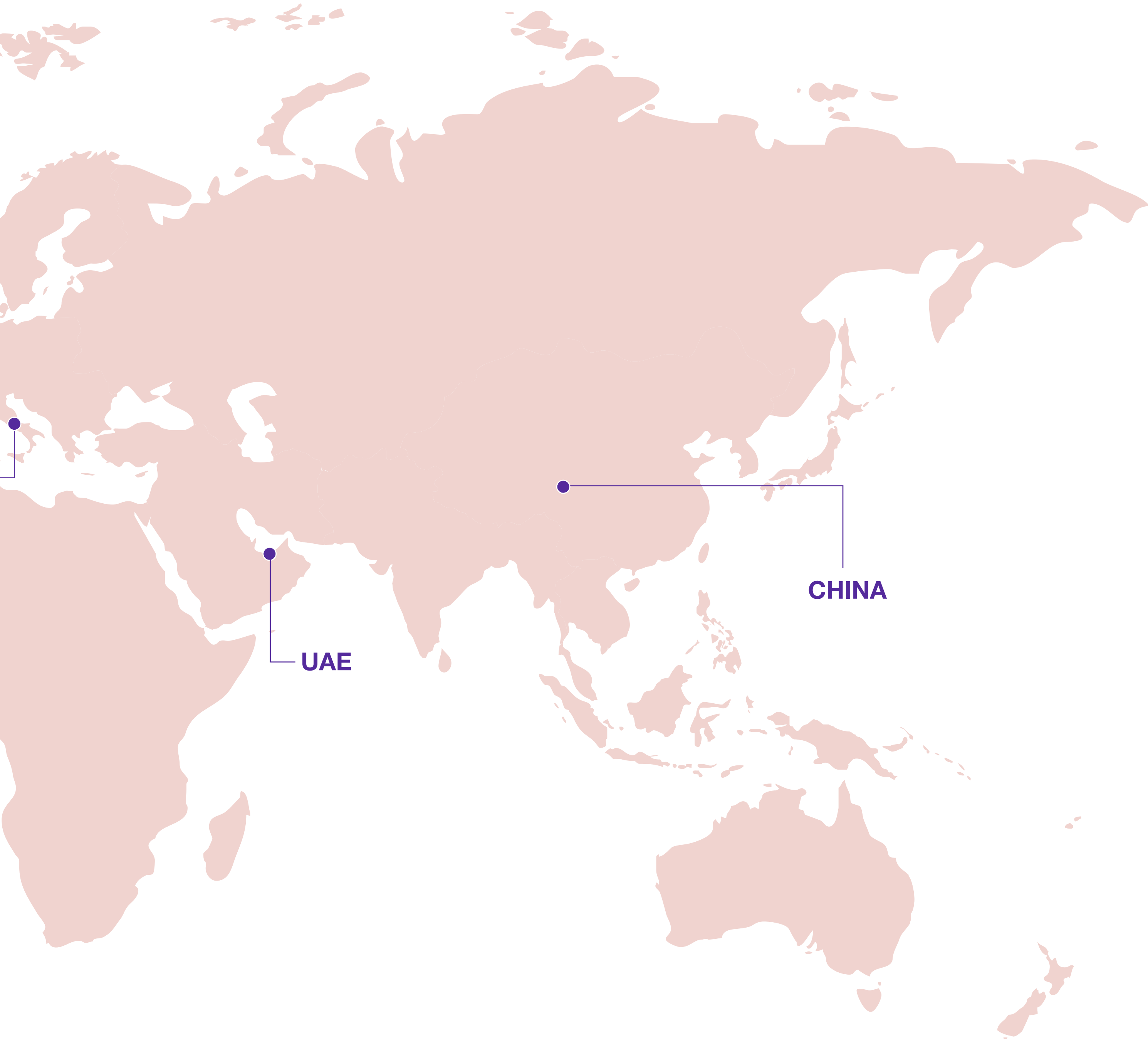
World Map

Please click on the country name on the interactive map below to take you directly to the relevant chapter.




UAE
CHINA

China

C-ROSS – China's new risk-based capital framework

In February 2015, the China Insurance Regulatory Commission ("CIRC") issued technical standards for a new set of solvency regulations, the China Risk Oriented Solvency System ("C-ROSS"). These replace the current solvency requirements on Chinese insurance companies.

C-ROSS adopts the internationally accepted "three-pillar" regulatory system which includes quantitative capital requirements, qualitative regulatory requirements and market discipline mechanisms while its regulatory concept, models, methods and parameters are based on Chinese insurance market conditions. As C-ROSS comprises a new set of regulations and is therefore untested, interpretation and enforcement involves uncertainties. CIRC announced an official implementation of C-ROSS in the first quarter of 2016.

As a result of the implementation of C-ROSS, Chinese insurers are starting to take a much closer look at asset mix and offshore investment opportunities. This is because the way assets and liabilities are valued will change and firms will need to re-examine the mismatch gap. Any firms that are badly mismatched could have a significant capital charge. Chinese insurers will look abroad, in order to close the mismatch gap and to find higher-yielding assets to replace equities that under C-ROSS will become more expensive. By contrast, the types of assets Chinese insurers can purchase onshore are very limited. Under the new rules relating to investment of insurance funds issued by CIRC, Chinese insurers are allowed to invest no more than 15% of their total asset allocation overseas. This was raised from a limit of 5% in 2012 to give insurers the possibility of earning better and more stable returns from offshore asset allocation.

However, given the continuing pressures of capital outflow and currency depreciation, the State Administration of Foreign Exchange ("**SAFE**") has not granted any new offshore investment quota to any type of qualified domestic institutional investors ("**QDIIs**") (including insurance QDIIs) this year. It is anticipated to be more challenging to obtain additional quota from SAFE for various outbound investment schemes (including but not limited to the QDII scheme) in the near future. A limited investment quota could give rise to a major hurdle for Chinese insurers to gain more exposures to offshore assets.

CIRC seeks comments on capital replenishment rules for insurance companies

Following the first consultation draft on 6 November 2014, CIRC released the second draft of the 'Administrative Measures for the Capital Replenishment of Insurance Companies' to seek public opinions by 15 February 2016. Compared to the first draft, the second draft does not seem to propose many material changes. Among others, the key aspects include:

- Insurance companies may use a variety of ways to replenish their actual capital, including but not limited to common stocks, preferred stocks, capital reserves, retained earnings, debt capital instruments, contingent capital, insurance policy securitisation products, unconventional reinsurance and other qualified capital instruments;
- An insurance company may carry out an experimental capital instruments innovation programme if it meets the following requirements:
  - (i) it has been rated A or B for two consecutive years in the classified supervision rating;
  - (ii) its core solvency adequacy ratio exceeds 80% for two consecutive years; and
  - (iii) it has not been subject to severe administrative penalties by CIRC in the past two years; and
- in particular, if an insurance company intends to issue debt capital instruments offshore, it should obtain a supervisory opinion issued by CIRC. However, the consultation draft does not mention whether the insurance company should seek additional approvals from other regulators.

The proposals aim to facilitate Chinese insurers offering a variety of C-ROSS compliant capital instruments. The proposals may also provide an opportunity to global market players who can introduce sophisticated fund raising structures into the capital offerings of Chinese insurers.

Insurance growth in the Fintech industry

On 22 July 2015, CIRC released the 'Interim Measures for Regulating the Internet Insurance Business' ("the Measures"), which came into

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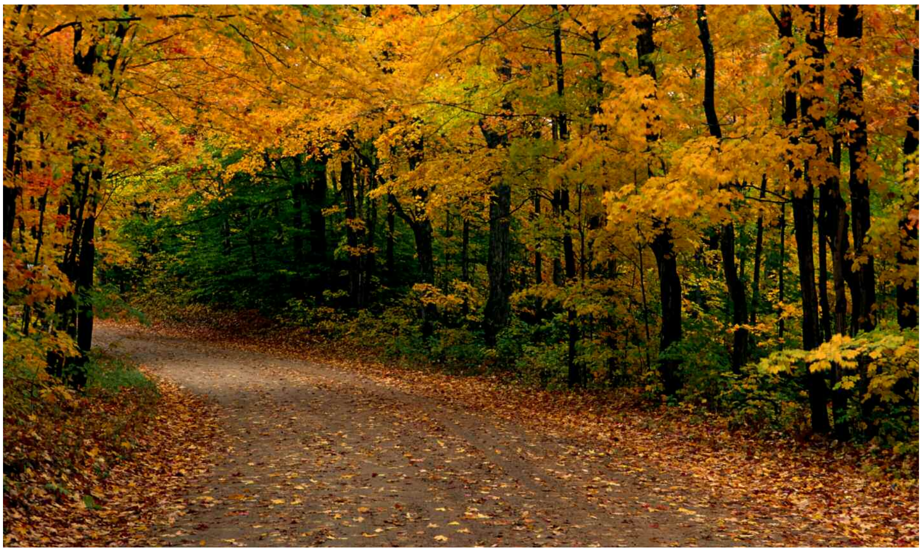
effect as of 1 October 2015. This regulation aims to encourage the emerging online insurance business to develop in an orderly manner. This is broadly driven by the Chinese central government's national "Internet plus" strategy across the real economy, as well as the increasing demand for the existing regulatory regime to accommodate the fast-changing marketplace.

The Measures will apply to insurance services through self-operated or third-party operated online platforms, using internet and/or mobile communication technologies. Foreign funded insurers are equally permitted to carry on online insurance business as long as the requirements in respect of eligibility criteria, operational conditions, business areas and information disclosure etc. under the Measures are complied with.

An opportunity coming along with the Measures for foreign funded insurers would be easier expansion of geographic coverage. In China, an insurance company is only allowed to carry on insurance business in a province outside its registered address by setting up branches in the province, which would require additional capital injection, as well as investment of various operational resources. Foreign funded insurers often face greater burdens than their domestic counterparts in this process. However, the Measures offer the opportunity for Chinese insurers (in theory, including the foreign funded insurers) to expand geographic coverage of insurance business to provinces where they have not yet established a licensed branch office for a selected list of insurance products, currently including:

1. Accidental personal injury insurance, fixed-term life insurance and ordinary life-long life insurance;



2. Home property insurance, liability insurance, credit insurance and guarantee insurance, for which the policyholder or the insured is an individual; and
3. Property insurance for which the sale, underwriting and claim settlement can be processed online.

We have already noted foreign insurers join with Chinese insurers to take advantage of the geographic coverage offered by the latter and to also gain access to online platforms offered by the Measures. For example, in November 2015, Allianz, together with the China internet giant Baidu, and Hillhouse Capital Group, announced their plan to set up an online insurance company "Bai An". We expect to see further such joint ventures in the remainder of 2016 and into 2017.

Reinsurance regime update

The reinsurance regulatory regime in China has recently experienced two major developments which may be of interest to foreign participants, namely, a relaxation on approval of affiliated reinsurance transactions and a new registration system for the People's Republic of China ("PRC") insurance companies.

Relaxed management on affiliated reinsurance transactions

In early 2015, CIRC removed the prior approval requirement on affiliated reinsurance transactions of foreign invested insurance companies in China. Instead, CIRC has requested all affiliated reinsurance transactions (both domestic and cross-border) to be reported periodically to CIRC. In October 2015, CIRC revised the Reinsurance Regulation to reflect this relaxed regime.

New Registration System

The new reinsurance registration system came into effect from 1 January 2016. All domestic and foreign reinsurers and reinsurance brokers that enter into reinsurance business with PRC insurance companies are required to register with the reinsurance registration system. If they cannot complete the registration, they cease being a qualified reinsurer to whom PRC insurance contracts can be ceded.

A foreign reinsurer will need to be recommended by its affiliates in China to complete the registration.

Healthcare insurance update

Commercial healthcare insurance is the insurance whereby an insurance company pays the premium for the loss arising from health reason and medical action.

Facing increasing needs beyond the coverage of basic medical insurance, the Chinese government issued the *Several Opinions of the General Office of the State Council on Accelerating the Development of Commercial Health Insurance* ("**Opinions**") to show its determination to develop the market.

In the Opinions, the Chinese government recognises commercial healthcare insurances as an effective, supplementary tool addressing needs not covered by basic medical insurance. Moreover, according to a circular jointly issued by the State Administration of Taxation, the Ministry of Finance and CIRC in November 2015, where individuals purchase compliant healthcare insurance products in the selected pilot areas (including 31 cities), the premium shall be deductible from individual income tax subject to an upper premium limit of RMB 2400 per year. This may make commercial healthcare insurance more appealing to the public.

However, the profitability of healthcare insurance business has not been as good as expected. From February to May 2016, average profit of insurance companies deriving from healthcare insurance was about RMB1 million. This may result from the limitations applicable to both the insured and insurance companies. The insured are confined to taxpayer groups aged 16 or above and under mandatory retirement age, which prevents other groups from obtaining coverage. Meanwhile, there are even more limits on insurance companies, especially on foreign insurance companies. CIRC required that the simple loss ratio of medical insurance (part of healthcare insurance) shall not be less than 80% and insurance companies shall not decline to write a policy due to the medical history of the insured. With respect to joint venture insurance companies engaging in personal insurances, it is still a general requirement that the foreign stake shall not exceed 50% of the total equity.

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EU

Implementation of Solvency II

Solvency II, an EU-wide legislative solvency and supervisory regime for (re)insurers, came into force on 1 January 2016. The regime took over 10 years to develop and over £3bn in investment by insurers in the UK alone. The objectives of Solvency II are straightforward – to improve consumer protection, modernise supervision, deepen EU market integration and to increase the competitiveness of EU insurers. However, it is too early to say whether all these objectives have been or will be met.

We do note, however, that Solvency II has given rise to further complexities in areas where our clients were perhaps not expecting it. For example, we have noted increased instructions on:

- Reporting
- Data security and investment
- Recruitment
- Investment in infrastructure

Reporting

Solvency II reporting requirements have greatly increased data demands on insurers and in turn, we have particularly noted an increase in queries from asset managers who are looking to provide their insurer clients with data to meet the look-through requirement.

From discussions with asset managers, it is clear that there are two sets of disclosures that insurers seek to obtain from asset managers. Firstly, there is provision of a data file which is made up of quantitative data. Due to the detail needed for the look-through, a common solution appears to be that the asset manager arranges for the required data to be provided to the insurer by third parties specialising in providing such support services, meaning that the asset managers do not incur further costs. Secondly, in relation to a duty with respect to the quality of the information provided, which derives from Article 35(4) of the Solvency II Directive, asset managers are agreeing to give access to insurers to allow due diligence of certain relevant internal processes and controls, which may include a site visit. For further detail on the impact of Solvency II for asset managers, please see our recent briefing on **investments by firms under Solvency II**.

Data security and investment

Solvency II is generating large amounts of new complex data, and in light of well publicised cyber attacks, information security is a top priority for insurers in 2016. In light of this, we note an increase in the acquisition of experts in Big Data and Cyber Security and a significant investment by insurers to modernise systems and processes in preparation for Solvency II.

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One particular challenge is the move by insurers to a reporting infrastructure that allows the production of reports in eXtensible Business Reporting Language ("XBRL"), the filing format specified by European Insurance and Occupational Pensions Authority ("EIOPA"). Harmonised EU-wide reporting formats are, as suggested by EIOPA, to ensure a consistent implementation of Solvency II. Although XBRL reporting is mandatory between the National Competent Authorities ("NCAs") and EIOPA, some NCAs (such as the PRA in the UK) are requesting that their regulated firms also submit their quantitative returns in XBRL.

Recruitment

There has been an increase in recruitment in areas posing a risk to Solvency II compliance e.g. in data security and in hiring actuarial and risk professionals. However, there also appears to be a marked shift towards hiring senior executives and management to meet the new Solvency II governance requirements.

This recruitment activity follows the need for insurers to reassess their governance structure and, in particular, to identify 'key functions' and to ensure persons within those functions are 'fit and proper' in line with Solvency II requirements. Separately, we will need to wait and see whether Article 275 of the Solvency II Delegated Regulation 2015/35 (which sets out prescriptive requirements on remuneration) impacts on recruitment especially at the senior level. The implementation of the Article 275 also risks the consistent harmonisation objective because of some ambiguous terminology used in the provision e.g. the meaning of 'material risks takers' as used in Article 275(2). For further discussion on Solvency II remuneration requirements, including the PRA's approach to this, please refer to our briefing.

Investment in infrastructure

Following a political desire to create better incentives for insurers to invest in infrastructure projects, the Solvency II Delegated Regulation 2015/35 was amended in September 2015 to introduce a lower capital charge for investments in 'qualifying infrastructure investments' – please refer to our commentary on **new asset class for insurers**.

Although insurers welcomed the change, the new requirements were stringent and constructed in a way which excluded projects which the EU may have liked to promote following its original rationale for the changes. The European Commission subsequently acknowledged that the legislation required refinement.

In June 2016, EIOPA published an advice to the Commission which recommended extending the infrastructure asset class in two ways:

- To allow certain infrastructure corporates to qualify for the capital treatment for infrastructure projects provided that there is an equivalent level of risk.
- To create a separate differentiated treatment for equity investments in high-quality infrastructure corporates.

For those corporates that have a lower risk profile, EIOPA proposes a reduction in the risk charges for equity investments. We will wait to see how insurers respond to these proposals, however, given the appetite for portfolio diversification following Solvency II, we expect to see increased queries in this area.

The Insurance Distribution Directive

The Insurance Distribution Directive ("IDD") entered into force on 22 February 2016 and Member States will have two years to comply with the new requirements. The IDD supersedes the Insurance Mediation Directive ("IMD") and, although it is a minimum harmonisation directive, it is intended to better harmonise the regulation of insurance distribution, which is needed given the uneven national implementation of IMD by Member States.

Significantly, the IDD contains new definitions in respect of 'insurance distribution', 'insurance intermediary' and 'ancillary insurance intermediary'. Therefore, we have assisted clients to determine whether they are caught in the new scope, or whether they can still benefit from the 'Connected Contracts Exemption' following refinements to this in the IDD. For more information on IDD provisions, please refer to **our previous IDD briefing**.

Retail or professional

Insurers who sell to non-retail clients (e.g. insurers who sell longevity insurers to pension schemes) fall within scope of the IDD as do reinsurers because of the widely drafted 'insurance distribution' definition. However, each provision of the IDD will need to be analysed to ascertain any resultant impact to non-retail insurers and reinsurers. This is because some of the IDD provisions place obligations on insurance distributors only whilst others make reference to 'consumers' or 'customer'. There is no general definition of 'consumer' or 'customer' in the final text of IDD but it is clear from the use of the terms that they are directed at retail customers.

The term 'professional client' is used in the IDD but only in Recital 51 and Article 22(1). It is defined, by reference to Article 4(1)(10) of the **MIFID II Directive**, to mean a client who 'possesses the experience, knowledge and expertise to make their own investment decisions and properly assess the risks they incur'. The definition expressly includes pension funds and management companies of such funds.

Recital 51 of the IDD confirms that, in some cases, where the customer is a professional client there is less need for the provision of information to enable a customer to make an informed choice. This expectation is confirmed in Article 22(1) IDD which allows Member States to disapply the IDD information requirements where a customer is a professional client but only in respect of insurance-based investment ("IBI") products. For further information on such requirements, please see **our MIFID II and IDD briefing**.

In the UK, implementation of the IMD was gold-plated and so many of the changes introduced by the IDD are already implemented in the UK

Nevertheless, these are areas where the IDD will have an impact on current requirements such as professional requirements, management of incentives and conflicts, remuneration reasons for the non-life sector and product governance requirements.

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Germany

Reinsurance business of third-country (re)insurers in the European Economic Area

The EU Solvency II Directive (2009/138/EC) ("**Solvency II**") does not set out in detail how (re)insurers who are domiciled outside the European Economic Area ("**EEA**") and wish to do reinsurance business in an EU Member State should be regulated. The German legislator has introduced a regulatory regime that privileges (re)insurers from those third countries for which the EU Commission has confirmed that their solvency regime is equivalent to that under Solvency II. So far, the EU Commission has confirmed equivalence in this sense for Switzerland, Bermuda and Japan.

(Re)insurers from such "equivalent" third countries may solicit business with German cedants on a cross-border basis from their head office (but not through a branch located in another country) without requiring a licence. Only if these (re)insurers wish to act from a permanent presence in Germany do they need to establish a licensed and regulated German branch.

By contrast, (re)insurers with head office in "non-equivalent" third countries, including the US, either need to establish a German branch which is authorised and regulated in Germany or must limit any reinsurance business with German cedants to so-called correspondence business. Consequently, the definition of "correspondence business" has become particularly relevant for these (re)insurers.

On 31 August 2016, the German Federal Financial Services Authority (*Bundesanstalt für Finanzdienstleistungaufsicht*, "**BaFin**") has provided some guidance to the effect that third-country (re)insurers conduct regulated business in Germany if they target the German market to solicit business with German cedants.

However, BaFin considers that in-bound activities constitute "correspondence business" if, at the instigation of a German cedant, a reinsurance contract is concluded by correspondence "without one of the parties being assisted by a professional intermediary in Germany or a professional intermediary domiciled abroad but acting as intermediary in Germany". Therefore, any brokers involved in the conclusion of reinsurance contracts with German cedants must – in the context of correspondence business – generally neither be domiciled nor do business in Germany.

However, BaFin has slightly relaxed its previously published position and now permits an involvement of brokers acting in Germany who advise or assist the cedant with the preparation or conclusion of a reinsurance contract as long as the third country (re)insurer does not target the German market through the broker, i.e. the initiative for the conclusion of the contract is clearly taken by the cedant.

Despite BaFin's publication, correspondence business with German cedants remains a field where (re)insurers from non-equivalent third countries must be careful to avoid trespassing the border of regulated business which remains subject to authorisation.

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Italy

IVASS issues regulation on financial stability reporting

The Istituto per la Vigilanza sulle Assicurazioni ("IVASS") published Regulation No. 21 dated 10 May 2016, which sets out provisions on the periodic quantitative information to be transmitted to IVASS with the purpose of ensuring financial stability and exercising macro-prudential supervision (financial stability reporting), in accordance with Articles 190 and 191 of Legislative Decree no. 209 of 7 September 2005 (the Italian Insurance Act) and with the European Insurance and Occupational Pensions Authority's ("EIOPA") guidelines on reporting for financial stability purposes (Third Pillar).

Pursuant to the Italian Insurance Act, IVASS – through the publication of this Regulation no. 21 – has set out detailed provisions on disclosure requirements which, amongst others, insurance companies, reinsurance companies, Italian branches of companies with registered office in a third country must follow for the purposes of the collection of information for financial stability and macro-prudential supervision.

Consistently with the EIOPA guidelines, Regulation no. 21 ensures a uniform application of the new system of data collection for the purposes of financial stability, to allow for further convergence of supervisory practices and to complete the existing regulatory framework.

Regulation no. 21 gives its own organic structure to the provisions related to data on financial stability. This permits taking into account data collection requirements on a national and international basis, as well as need for collected data rationalisation from various sources because of the continuous data flow in the "Solvency II" prudential reporting, as set out under the implementing Regulation (EU) no. 2015/2450 on the submission of information to supervisory authorities.

Regulation on supervision of insurance groups published in Official Gazette

Regulation of the Italian Insurance Regulator (IVASS) (no. 22, dated 1 June 2016), which has been published in the Italian Official Gazette, sets out provisions on the supervision of insurance groups in accordance with Legislative Decree no. 209 of 7 September 2005 (Italian Insurance Act) and implements the EIOPA guidelines on the methodology for equivalence assessments by national supervisory authorities in accordance with Solvency II.

In the context of the regulatory framework as amended by Delegated Regulation (EU) no. 2015/35, Regulation no. 22 intends to provide the legal framework relating to the technical measures implementing the provisions on group supervision (including group solvency, monitoring of infra-group operations, concentration of risks, governance).

It must be pointed out that Regulation no. 22, unlike the previous regime, does not reproduce Article 5, paragraph 2, of IVASS Regulation no. 15/2008 which stipulated that, under certain conditions, it was possible for IVASS to identify as parent company a different corporate entity which, although not at the top of the structure, pursues the direction and coordination of the group. The absence of such a provision in the new regulatory regime is due to significant innovation brought by Solvency II on group supervision.

IVASS issues regulation on investments and assets covering technical provisions

IVASS, the Italian insurance regulator, published Regulation no. 24, dated 6 June 2016, which lays down provisions concerning eligible investments and assets covering technical provisions, also implementing the European Insurance and Occupational

Pensions Authority (EIOPA) guidelines on system of governance, with specific reference to the 'prudent person principle'.

Regulation no. 24 also sets out rules concerning the granting of loans to corporate entities, as well as the maintenance of the technical provisions register and the application of the 'prudent person principle' in the context of group supervision.

The insurance company's monitoring function on its results and financial position is characterised by a significant reinforcement of the internal control system in accordance with the EIOPA guidelines and the related explanatory text. Consistently with the EIOPA guidelines, the insurance and reinsurances companies are called to identify, assess, monitor, manage, control and properly report the risks, to ensure safety, quality, liquidity and profitability of the portfolio as a whole, and by identifying activities according to criteria ensuring availability.

To ensure compliance with the "prudent person" principle in investment management, insurance companies define their investment, activity management, liability and liquidity risk management policies in compliance with the nature, the scope and the complexity5of the company's activity.

The administrative body must approve the abovementioned policies by adopting a specific framework resolution which should be reassessed at least on a yearly basis.

Amongst other things, Regulation no. 24 sets out the conditions under which Italian insurance companies may engage in the business of financing with the public (excluding individuals and micro-enterprises).

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Luxembourg

Solvency II implementation

The Luxembourg acts implementing the Solvency II Directive 2009/138/EC have been published in the Luxembourg official journal (*Mémorial A*) on 9 December 2015:

- the law of 7 December 2015 on the insurance sector, constituting a complete redraft of and replacement for the former Luxembourg insurance sector law of 6 December 1991 (as amended)
- the law of 7 December 2015 amending the law of 27 July 1997 on insurance contracts and the law of 8 December 1994 on annual accounts and consolidated accounts of Luxembourg insurance and reinsurance undertakings
- regulation N° 15/03 of 7 December 2015 on insurance and reinsurance undertakings by the Luxembourg insurance sector supervisory authority, Commissariat aux Assurances ("**CAA**").

The Solvency II implementing acts entered into force on 1 January 2016, subject to limited exceptions and the transitional regime as foreseen under Solvency II.

Further implementing acts include the CAA Circular 15/13 dated 15 December on supplementary Solvency II Guidelines published by EIOPA on 14 September 2015 as well as the CAA information notice dated 20 July 2016 on EIOPA Preparatory Guidelines on product oversight and governance arrangements by insurance undertakings and insurance distributors, both confirming that the CAA fully complies or intends to fully comply with these guidelines.

The implementation of the Solvency II framework and the ensuing overhaul of the legislative framework for the Luxembourg insurance and reinsurance sector mark the latest step taken by the sector towards full Solvency II compliance. In its annual report, the CAA highlighted in this respect the significant efforts by the industry players to comply with the new rules as well as the fructuous cooperation between the sector and the CAA, notably as regards the internal models of risk evaluation and reporting.

Amidst these efforts and a low interest rate environment, the Luxembourg insurance and reinsurance undertakings have nevertheless managed to stabilise their growth, and outlooks by the CAA and the industry appear promising.

Other Publications in relation to the Insurance Sector

The CAA issued several information notices and circulars over the last year focusing on reporting (including Solvency II reporting) matters (including the Information Notice dated 14 January 2015 and Circulars 15/10, 16/1, 16/3, 16/4, 16/5 and 16/7) as well as Circular 16/6 on financial construction completion guarantees (*garanties financières d'achèvement*) issued by insurance undertakings in the context of sales of Luxembourg real estate in the process of construction, which are of

increased relevance in light of the growing construction sector in Luxembourg.

The Luxembourg Central Bank published Circular N° 2015/239 on the introduction of a statistical data collection system for insurance corporations developed on the basis of the European Central Bank's statistical activities legal framework, and particularly ECB Regulation 2014/50, which is addressed to insurance corporations incorporated and resident in Luxembourg, including branches registered in the Luxembourg Commercial Register whose parent entities are located abroad.

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Spain

New regulation on information to be submitted in relation to acquisitions of significant shareholdings and fit and proper requirements for (re)insurance entities.

1 January 2016 saw the entry into force of Act 20/2015, of 14 July, on the regulation, supervision and solvency of insurers and reinsurers ("**LOSSEAR**") and its implementing regulations, Royal Decree 1060/2015, of 20 November ("**ROSSEAR**") which transposed EU Directive 2009/138 on the taking-up and pursuit of the business of insurance and reinsurance (Solvency II) (the "**Solvency II Directive**") into Spanish law.

As a consequence of the entry into force of LOSSEAR and ROSSEAR the Ministry of Economy and Competitiveness has enacted Order ECC/664/2016, of 27 April, which approves the list of information to be sent in relation to acquisitions or increases of significant shareholdings in (re)insurance entities and for persons who effectively run (re)insurance companies, or holders of key functions of the system of governance of (re)insurance entities and groups ("**Order ECC/664**").

Order ECC/664, which replaced prior Order EHA/3241/2010 ("**Order EHA/3241**") on this same topic, entered into force on 7 May 2016, applying from 1 January 2016, as it is understood that the requirements to which it related were also applicable from 1 January 2016 in accordance with LOSSEAR, ROSSEAR and other relevant EU rules.

Acquisitions and increases of significant shareholdings

Order ECC/664 contains basically the same type of information as that included previously in Order EHA/3241, except for the fact that it has taken into account the developments included in the draft Joint guidelines on prudential assessment of acquisitions and increases of qualifying holdings in the financial sector dated 3 July 2015 (the "**Draft Joint Guidelines**"). For example, more information is required in relation to (i) the requested CVs; (ii) financial statements; or (iii) in the case of acquisitions in which the proposed acquirer is a sovereign fund (which were not specifically dealt with beforehand).

Fit and proper information

Annex II of Order ECC/664 includes the fit and proper information to be provided by the relevant entities regarding (i) the persons who effectively run (re)insurance companies or insurance holding companies or mixed financial holding companies and (ii) holders of key functions. It should be noted that Annex II contains some additional information, (i) a description of professional activities for the last 10 years (instead of the last 5 years as previously applied) in greater detail; and (ii) collective assessment of the management body's qualifications, experience and knowledge of at least insurance and financial markets; business strategy and business model; system of governance; financial and actuarial analysis; and regulatory framework and requirements.

Filing of information

Order ECC/664 also includes an additional provision regarding the filing of information in relation to outsourcing.

It should be noted that Order ECC/664 only allows all this information to be filed with the Spanish insurance regulator (the "**DGSFP**") electronically using certain forms that can be found on the website of the DGSFP. Therefore, in the event the entity that has the obligation to do the filing is not authorised to file information electronically with the DGSFP, certain steps would first have to be executed to get the necessary approval before performing the relevant electronic filing.

The DGSFP clarified on 21 May 2016 some issues raised by the Spanish Insurers Association ("**UNESPA**") in relation to the interpretation of the Order ECC/664.

In particular, the DGSFP clarified that those persons who effectively run (re)insurance companies and who were registered with the relevant Registry of the DGSFP at 31 December 2015 do not need to file additional information to prove that they fulfil the fit and proper requirements. However, the DGSFP can at any time ask the relevant entities for information which proves that such individuals fulfil the fit and proper requirements.

Regarding the collective assessment of the management body mentioned above, the DGSFP confirmed that, as this is a new requirement applicable from 1 January 2016, even companies where the members of the management body were appointed before such date (and have not changed) need to prove that the new collective assessment requirement is duly fulfilled. The fulfilment of such requirement can be proved as mentioned in Annex II of Order ECC/664 by a certificate of the secretary of the board of directors or the relevant management body.

A new Audit Law requires insurance entities to have an Audit Committee

Spanish Law 22/2015 regarding the auditing of accounts (the "**Audit Law**") requires since 17 June 2016 that so-called "Public Interest Entities" (which includes all insurance entities) establish an Audit Committee with the requirements of article 529 quaterdecies of the Spanish Companies Act. Such article was previously enforceable for all listed entities (including listed insurance companies), but now the Audit Law makes it applicable for all insurance entities whether they are listed or not. The Audit Law includes certain limited exemptions to this obligation.

A series of concerns regarding potential exemptions and the composition of the Audit Committee have arisen within the insurance sector. UNESPA posed several questions to the Spanish Stock Market Commission (the "**CNMV**") (which is the body in charge of the interpretation of this new rule) with the below described results.

A first issue was how to interpret the legal requirement that more than half of the members of the Audit Committee must be independent directors. The CNMV has accepted in its response to the UNESPA query that the Audit Committee may exceptionally be composed of two members as long as the chairperson of the Committee is an independent director with a casting vote.

A second issue was how to apply the requirement to have an Audit Committee in groups with several insurance entities and to what extent it would be enough to have an Audit Committee at group level which assumes the Audit Committee functions also at the level of the relevant subsidiaries. The CNMV has clarified that each insurance entity should have an Audit Committee unless all requirements of Additional Provision 3ª d) of the Audit law are fulfilled.[1]

Another issue was to what extent insurance entities might be exempted from having an Audit Committee on the basis of the exemption mentioned in second paragraph of Additional Disposition 3ª as they already have a similar body (the one in charge of the internal audit function). The CNMV, however, rejected such possibility.

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1 Such provision requires for the exemption to apply that:
(i) subsidiary company/ies are fully owned by the holding company (concept of subsidiary company according to art. 42 of Spanish Commercial Code);
(ii) subsidiary company/ies do not have as management body a Board of Directors; and (iii) the Audit Committee of the holding Company assumes the functions of the Audit Committee in each and every Subsidiary Company.
Additionally, the relevant entities must publish the reasons why they consider that is not appropriate to have an Audit Committee in the subsidiaries on their websites.

UAE

In the UAE, the insurance market continues to implement the Insurance Financial Regulations published by the UAE Insurance Authority (the "Insurance Authority") in 2014 which, as described in detail in the last edition of Insurance Global, created a new regime for the financial, technical, investment, and accounting operations of traditional and takaful insurers operating in the UAE, including branches of foreign insurers. The Insurance Financial Regulations are due to be implemented in phases concluding in January 2018.

Recent initiatives have also been adopted by the UAE Insurance Authority to seek compliance across the market with Article 25 of the UAE's Insurance Law (Federal Law No. 6 of 2007), which broadly requires insurance companies carrying on both life and non-life insurance activities to separate those businesses. The deadline for compliance with Article 25 was extended in 2015 to 28 August 2016, however, firms had been unclear of how the separation could be achieved without creating a new subsidiary for life business.

Pursuant to a recent 2016 resolution published by the Insurance Authority, composite firms are now required to perform a "complete separation" of internal systems, records and procedures and prepare separate reports. Whilst the instructions of the Insurance Authority have paved the way for composite insurers to prepare an internal (rather than legal) separation, the requirements have been administratively burdensome for firms also forced by the prescriptive wording of the instructions to try to separate shared functions across the business.

Further, in February 2016, the Insurance Authority announced it is considering the establishment of a national life insurance company to hold the life insurance portfolios currently held by UAE insurers (the "**National Life Insurance Company**"). Life business would be transferred to the National Life Insurance Company, insurers would hold shares in the National Life Insurance Company and have representation through its board. The stated aims of the proposal are to increase the UAE life insurance market's regional and global competitiveness and to create a more robust life insurance sector. In addition, this route would provide the opportunity to ensure compliance with the Article 25 separation requirement by legally separating all life business.

No timeline has been set for when the proposal may become law or, once issued, the time period for the company to be created and existing life business to be moved across. Many details remain outstanding from a legal and commercial perspective and we expect a significant period for further consultation with the market, if the proposals are taken forward by the Insurance Authority. It is also unclear whether the companies who will take part in the National Life Insurance Company would be locally established life and composite insurers only, or whether UAE branches of foreign insurers will be required to contribute as well. The life insurance market in the UAE is split 81:19 between foreign and local companies and we expect the proposals may also aim to strengthen the position of local insurers in the market.

Certain larger market participants doubt that the plans for a National Life Insurance Company will take off, given the draconian nature of a forced asset transfer potentially depriving shareholders of composite insurers of significant value. One possible scope for the national fund would be a tool for smaller firms struggling to cope with the Article 25 separation requirements, who do not have adequate scale to run a separate life business internally.

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UK

Brexit Referendum Result

On 23 June 2016, the British electorate voted to leave the EU. The UK government has made clear that it will respect the decision, although there is uncertainty as to when the exit will come into force.

The date of exit is dependent on when the UK serves an Article 50 notice to the European Council. Following Article 50 requirements, EU Treaties (and all associated EU law) will cease to apply to the UK on the entry into force of a withdrawal agreement or, if no new agreement is concluded, after two years (from the date the Article 50 notice was served), unless there is unanimous agreement to extend the negotiating period.

There has been little official publically available information on the date that Article 50 notice will be served. However, at the recent Tory party conference, Theresa May confirmed that it would be triggered by March 2017. There is also much speculation in the UK press on the UK's approach to the EU, including its position on access to the Single Market, which of will be interest of (re)insurers based in the UK and those accessing the UK market from the EU. Theresa May has hinted that she will deliver a 'hard Brexit' – with no compromise on border controls, however, what this means in practice, and what impact it will have on the financial services market in the UK remains to be seen.

In any event, we have been advising a number of (re)insurers on capital regulatory requirements given the significant market fluctuations experienced following the result and on their Brexit contingency planning. Further information on these immediate impacts and on Brexit planning considerations, please refer to our briefing – Brexit: what next for the insurance sector?

Firms have begun to identify the key aspects of their businesses which will be impacted once the UK leaves the EU and the material business risks which might follow. Key challenges include altering corporate structures (in the most capital efficient way) in order to maintain profitable access to relevant markets.

An important consideration in respect of such planning and future business strategies is losing access currently permitted by passporting. We have considered the possible scenarios following the loss of passporting rights, for instance, the establishment of an UK/EEA base, fast track authorisations and the impact of Solvency II equivalence provisions should the UK become a 'third country' – plus the means for our clients to lobby on Brexit – for more detail, please refer to Brexit: Passporting and equivalence implications for the UK insurance sector.

SIMR and the PRA's focus on Governance

The Senior Insurance Managers Regime (SIMR) came into force on 7 March 2016 and increases accountability and responsibilities of senior managers and directors in insurance firms. It is also the UK's means of transposing Solvency II governance requirements (although it is a significant extension of these requirements) and includes measures to

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ensure the fitness and propriety of senior managers. We have been assisting our clients with all aspects of SIMR, including the identification of 'Key Function Holders', allocation of prescribed responsibilities to persons approved by the PRA or FCA, the creation of a governance map and measures to ensure its update. Further details on SIMR (including a critique on its implementation) can be found in our briefing Strengthening accountability: SIMR and the PRA's focus on Governance.

Alongside the introduction of SIMR and with a renewed drive to strengthen accountability, the PRA in early 2016 published its Supervisory Statement on Corporate Governance (SS5/16). This guidance set out, for the first time, a clear regulatory expectation on firms to have transparent and effective governance structures. Along with SS5/16, firms regulated by the PRA should act in line with the UK Corporate Governance Code.

SS5/16 is significant as it outlines the PRA expectation of the collective responsibilities of directors, as well as individual ones. For example, the PRA expects the chairman to lead the development of a firm's culture and standards by the board as a whole. Such PRA expectations are described as complementary to the expectations set out in the SIMR. SS5/16 states that whilst it is not intended as a comprehensive guide for boards as to what constitutes effective governance; it does suggest that there are certain areas the PRA regard as especially important. They include:

- culture
- setting strategy
- risk appetite, management and interim controls
- Board composition
- the respective roles of executive and non-executive directors
- knowledge and experience of non-executive directors
- the Board's time and resources
- management information and transparency
- succession planning
- remuneration
- subsidiary boards
- Board committees

SS5/16 makes clear that it is the board's responsibility to 'articulate and maintain a culture of risk awareness and ethical behaviour for the entire organisation to follow in pursuit of its business goal' – culture being a particular 'hot topic' with both the PRA and FCA during 2016.

Although the FCA has been fairly quiet about elaborating on its expectations on the 'right culture', the PRA makes it clear in SS5/16 that culture is to be embedded using incentives, such as remuneration, to encourage (or even require) the behaviours the board expects to see, and for this to be actively overseen by the board. In any case, we expect to see more messaging in 2017 by the PRA on the importance of corporate culture, and increasingly so by the FCA supervising its firms in relation to conduct risk. In line with this, towards late 2016 and early 2017, we hope to release a number of publications focused on conduct risk for financial institutions.

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USA

Using Non-Payment Insurance Policies for Credit Risk Weight Substitution under US Basel III Rules

Although a leader in the Basel Committee, the United States was slow to adopt the reforms set forth in the Third Basel Accord ("Basel III"). The final rules for advanced banking institutions were finalised in 2015 (12 C.F.R. Part 217, or "Regulation Q"), and many financial institutions are still determining how to balance the pursuit of new opportunities with significantly increased capital reserve requirements. To assist our clients, we are delighted to highlight our market-leading work developing non-payment insurance ("NPI") policies that may be used as a capital risk weight substitute under Regulation Q.

Basel III allows for capital risk weight substitution – whereby a financial institution substitutes the risk weight of a given exposure for the risk weight of the protection provider and thereby can significantly reduce the applicable capital reserve requirement – through the use of an eligible guarantee in the form of a letter of credit, unconditional guarantee, or NPI policy. Properly drafted NPI policies, which are less expensive than a letter of credit but still issued by a highly-rated provider, are ideal eligible guarantees. This practice is well developed in Europe, where our London colleagues have contributed to developing the NPI policy market, which is currently estimated to provide $25 billion in coverage.

Modern NPI policies tailored to Basel III requirements provide broad coverage which eliminates most traditional exclusions. Insurers have eagerly developed this new product, and NPI policies have earned a strong track record for prompt payment of claims.

However, many of our financial institution clients in the United States are unaware of the strength of modern NPI policies or that Regulation Q explicitly permits insurance to be used as an eligible guarantee. Regulation Q does differ in some key respects from the Basel III rules set forth in the European Union, but upon closer examination, it is clear that Regulation Q adheres to many of the same principles that have been extensively analysed in London.

Our expertise in this field has accordingly given us a strong head start on developing expert Regulation Q analysis, and we are currently working with several clients to develop Regulation Q compliant policies. As time goes on, we expect that many American financial institutions will begin to utilise this powerful tool for credit risk weight substitution.

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