HFW

INSURANCE BULLETIN
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"The One Call decision demonstrates the FCA's vigilant attitude to ensuring intermediaries comply with client money rules and have dedicated appropriate resources to ensure compliance."

1. REGULATION AND LEGISLATION

UK: One Call: FCA decision on client money breaches by an insurance intermediary

One Call Insurance Services Limited (One Call), an insurance intermediary primarily selling motor and household insurance through price comparison websites, was found to be in breach of client money rules. One Call was fined £684,000 and restricted for a period of time from charging renewal fees to its customers.

The FCA found One Call to be in breach due to:

- failure to appreciate that certain Terms of Business Agreements (TOBAs) did not provide effective risk transfer. One Call has relied on verbal assurances from insurers as to whether risk transfer would form part of the TOBA and had failed to check whether the TOBAs had effective risk transfer provisions; and
- failure to treat funds advanced by a third party premium finance company as client money. As these funds were being received in the course of or in connection with insurance mediation activity, the funds should have been held as client money. One Call failed to do this as it viewed the funds as a loan to One Call from the premium finance company.

The effect was that One Call inadvertently used client money to fund its own working capital requirements, make payments to directors and, indirectly, to capitalise a connected company, One Insurance Limited. The outcome had been that One Call had inadvertently spent client money for its own benefit resulting in a client money deficit of approximately £17.3m.

FCA Decision

In the FCA's decision, the FCA acknowledged that these failures may have arisen as a result of honest mistakes. The FCA found that the breaches were not committed deliberately or recklessly but they were negligent. However the FCA stated that had One Call appointed a competent, knowledgeable person and followed good industry practice of placing this function within an appropriate resourced finance function, the failing may not have been as serious. One Call has also received warnings from its external auditors that its treatment of client money may have been inadequate.

The FCA stated that the case was particularly serious because despite advice from the firm's external auditors, it took FCA intervention for One Call to arrange adequate protection for client money.

One Call thought it was protecting client money because it paid monies from customers into its client money bank account and only withdrew its commissions from the client money bank account once the insurer had been paid. Due to One Call's failure to appreciate that certain TOBAs did not provide effective risk transfer, One Call was paying both risk transfer money and non-risk transfer money into a client money account. As money was being co-mingled, the whole account should have been treated as client money. By failing to carry out adequate client money calculations and to maintain a surplus in the client money bank account, One Call failed to comply with client money rules. Had One Call become insolvent, the ownership of the money would not have been clear and litigation may have been required to determine whether money was client money or insurer money.

What is the takeaway for brokers?

The One Call decision demonstrates the FCA's vigilant attitude to ensuring intermediaries comply with client money rules and have dedicated appropriate resources to ensure compliance. It is important for brokers to review TOBAs carefully and to ensure they reflect the agreed client money arrangements. Brokers should also ensure that funds received in the course of insurance mediation activity are categorised correctly and treated as client money where required.

FCA Press Release: https://www.fca.org.uk/news/press-releases/fca-publishes-decision-notices-against-one-call-insurance-services-limited-and-john-lawrence-radford

FCA Decision Notice: https://www.fca.org.uk/publication/decision-notices/one-call-insurance-services-limited-2018.pdf

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UK: PRA Consultation – Solvency II, internal models and volatility adjustments

The Prudential Regulation Authority (the PRA) has published a consultation paper CP9/18 setting out its proposal to consider applications from internal model firms that include a dynamic volatility adjustment (DVA) under the Solvency II Directive.

The DVA aims to stabilise the Solvency II balance sheet during short periods of high market volatility by adding an extra spread component to the discount rate used for the calculation of technical provisions. It is one of the measures introduced in the so-called long term guarantee package concerning Solvency II valuation of insurance contracts with long term guarantees.

The proposal is relevant to all UK Solvency II firms and to the Society of Lloyd's and its managing agents, and in particular to those with or seeking volatility adjustment approval and who use a full or partial internal model to determine their solvency capital requirement.

The consultation paper sets out the proposed expectations of internal model firms when determining the risks that might arise from the DVA when calculating the solvency capital requirement. The PRA are also consulting on whether to allow firms to apply DVA in internal models when calculating solvency capital requirements.

The PRA's proposal is in a new supervisory statement: Solvency II: Internal models – volatility adjustment in the modelling of market risk and credit risk stresses. The PRA is also proposing to amend the Supervisory Statement 17/16 'Solvency II: internal models – assessment, model change and the role of non-executive directors'. These are set out in the appendices to the consultation paper.

The consultation will close on Wednesday 11 July 2018 and all feedback on the proposals should be provided on or before that deadline.

Please go to: https://bit.ly/2FzYltC to read the PRA Consultation Paper.

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2. COURT CASES AND ARBITRATION

England & Wales: Appointment of arbitrators in overlapping references

***Halliburton Company v Chubb Bermuda Insurance Ltd* [2018] EWCA Civ 817:**

In this case[1] the Court of Appeal assessed the extent to which an arbitrator could accept appointments in multiple references concerning the same or overlapping subject matter, without disclosure to the parties in the other arbitrations.

The case involved claims arising from an explosion and fire on the Deepwater Horizon oil rig which killed 11 crewmen and caused environmental damage along the US Gulf Coast. A group of plaintiffs sued Halliburton. Halliburton then made a claim under its liability insurance policy with Chubb. Chubb rejected the claim and Halliburton commenced arbitration.

M was appointed as the arbitrator in international commercial arbitration proceedings between Halliburton and Chubb. Halliburton subsequently discovered that Chubb had also appointed M as an arbitrator in two other arbitration proceedings concerning an overlapping subject

1. *Halliburton Company v Chubb Bermuda Insurance Ltd* [2018] EWCA Civ 817

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"The DVA aims to stabilise the Solvency II balance sheet during short periods of high market volatility by adding an extra spread component to the discount rate used for the calculation of technical provisions."

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"As a matter of English law, an arbitrator is obliged to disclose facts and circumstances known to the arbitrator which would or might give rise to justifiable doubts about his impartiality."

matter. Halliburton applied to have M removed as an arbitration under section 24(1)(a) of the Arbitration Act 1996, which provides that the court may remove an arbitrator when "circumstances exist that give rise to justifiable doubts as to his impartiality". The application was dismissed by the Commercial Court and Halliburton appealed.

Halliburton claimed that the first instance judge had failed to properly consider the unfairness that would arise from M's acceptance of the appointments in the other two proceedings involving Chubb and how M's appointment in the other references compromised his ability to be impartial.

The court considered that "inside information" might be a concern in multiple references with overlapping subject matter, however, such a concern did not justify the inference of apparent bias. The court agreed with Dyson LJ's dictum in *AMEC Capital Projects v Whitefriars City Estates* [2005] 1 WLR 723 where he considered that "the starting point is that an arbitrator should be trusted to decide the case solely on the evidence or other material adduced in the proceedings in question". It was held that the mere fact that an arbitrator accepts appointments in multiple references concerning the same or overlapping subject matter with only one common party does not itself justify doubts of impartiality. As Dyson LJ stated, "[s]omething more is required", that being "something of substance".

As a matter of English law, an arbitrator is obliged to disclose facts and circumstances known to the arbitrator which would or might give rise to justifiable doubts about his impartiality. The Court of Appeal considered that as a matter of good practice in international commercial arbitration and as a matter of law, disclosure should have been made to Halliburton at the time of M's appointment under the two other references. However, the Court of Appeal held that the fair-minded and informed observer would not conclude that there was a real possibility that M was biased if there was non-disclosure.

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3. MARKET DEVELOPMENTS

EU: The European expansion of London's insurers

The changing political landscape has prompted the London market to examine its European operations, bringing with it an upturn in growth in the continent.

Several insurers have indicated they are committed to European expansion, for example: Beazley has adapted its Dublin reinsurer into an insurance company which can conduct business across the EU with hubs in Barcelona and London; Markel International has applied for regulatory clearance to establish an insurance foothold in Germany; and Sompo International, which has launched a European specialty insurance underwriting function.

Companies are operating in an increasingly competitive world, placing ever-greater importance on seizing opportunities as and when they arise. Historically, the London market has not flourished in the European markets with the same success as it has elsewhere across the globe. The head of Europe at Liberty Specialty Markets (LSM), Kadidja Sinz has recognised that each country within the Eurozone brings with it requirements and was reported in Insurance Day as saying: *"some companies are more middle- to upper-middle markets, some countries have commercial giants"*, adding that, at LSM, *"we treat continental Europe as a region but we have dedicated approaches in each country"*.

One of the biggest tests for insurers in the London market in developing their operations in the continental European markets will be

distinguishing themselves from their European competitors. They will need to show that their product offerings meet the needs of the businesses in the different European territories. Insurance Day reports that Simon Wilson, managing director of national markets at Markel International, believes that due to the smaller size of London market players relative to the larger European players, *"the London player can be quicker and more nimble than competitors that typically have a vast array of products under management"*. Wilson explained that one of the key ways Markel International has secured success in the continental European markets is by *"focusing on being exceptionally good at a small number of products for an extended period of time"*, adding: *"rather than competing for the highly competitive large risk property/casualty business, I'd say London players are best sticking to smaller and more niche areas where fewer competitors have spent the time honing their products and expertise"*.

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4. HFW PUBLICATIONS AND EVENTS

HFW Briefing: "Is there a notable initiative in a market that can be developed into a Pan-Arab initiative?"

To a great extent banks and insurers are the "yin and yang" of operational risk. Banks have to deal with operational risk on a daily basis. Banks attempt to manage and mitigate these risks; and when they cannot, banks may attempt to transfer these risks to the insurance and reinsurance market. Insurers, for their part, attempt to understand and price the risk and then, in effect, remove that risk from the bank's balance sheet. HFW Partner John Barlow argues in this Briefing[1] that banks and insurers have much more in common than meets the eye and that new developments in their respective markets can significantly enhance the financial strength of the Pan-Arab region.

HFW Briefing: "Trade in a cold climate"

This year is proving to be an unpredictable and turbulent one for international state relations, with the imposition of tariffs by the US and China and the sanctions imposed by the US against various Russian individuals and companies being prominent recent examples. The effects are being felt amongst commodity traders worldwide: this article[2] by HFW Partners Brian Perrott, Daniel Martin and Geoffrey Conlin considers how they can minimise the impact of high level decisions on their businesses, including through the use of trade credit or political risk insurance.

1. http://www.hfw.com/downloads/HFW-Pan-Arab-initiative-April-2018.pdf
2. http://www.hfw.com/Trade-in-a-Cold-Climate-How-can-you-protect-yourself

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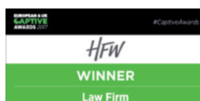

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