

Moving Into the Fast Lane?

Things are changing fast in the London insurance market ('the London market') from a practice and regulatory perspective, with the introduction of the Financial Services Authority (FSA) Contract Certainty Code of Practice being a landmark development in July 2007. However, in swift succession there have been a number of developments to this basic framework. A slew of related shake-ups have also had a real effect on the daily business of insurance practitioners. In the words of the Market Reform Group, "The market is not just changing, it is getting better at change"¹. Fundamentally, it is the explicit aim of the regulatory authorities to continue to drive change until London is the "market of choice" for insurance.

For markets such as Bermuda which regularly deal with the London market and the London financial market, an up-to-date knowledge of developments will be vital to ensure that business transactions can continue with ease. An understanding of the benefits and constraints of London market regulation and practice will greatly reduce the potential for friction between parties in different jurisdictions. Bermuda already enjoys a reputation for being progressive, and where the experience of the London market shows that a particular practice has demonstrable new benefits for clients, Bermudan companies may be able to take the racing line in adopting that change.

With this in mind, we are delighted to provide this snap shot of the current state of regulation in the London market. As the market continues to evolve we will continue to update you on the regulatory trends that may affect your business.

Contract Certainty and the Market Reform Contract

In July 2007 the FSA published its new Code of Practice on

Contract Certainty ('the Code'). The Market Reform Contract ('MRC') was also published and became a mandatory standard for the placement of general insurance contracts² on 1 November 2007. The guidance notes to the MRC provide further practical illustrations of how the Code is intended to operate.

The Code consolidates all the contract certainty work undertaken during the last two years by the Market Reform Group and is designed to ensure policies are fully agreed prior to coverage becoming active. Contract certainty procedures must be followed even if there is to be retroactive inception. Further, all post-contract changes, endorsements and side letters have to comply with the Code.

The publication of the new Code and guidance in the MRC represent an important stage in the development of the London market. The Code formalises the need for consideration of contract certainty principles from the earliest stages in the creation of a contract. The main provisions of the Code are briefly outlined below.

¹ Market Reform Newsletter February 2008, issue 34.

² Either those entered into by an FSA-regulated insurer, or arranged through an FSA-regulated intermediary – in practice the majority of insurance and reinsurance placements in London.



► *The Principles of the Code*

- 1 Before entering into a contract all terms must be clear, unambiguous and clearly expressed. This requirement is not new, but there are now examples of contract clauses such as subjectivities³ that show just how much detail the Code requires.
- 2 After entering into a contract the insured must receive all contract documentation promptly. This part of the Code has remained fairly consistent over the past two years.
- 3 The achievement of the principles in paragraphs 1 and 2 above must be demonstrated. Previously, demonstration of contract certainty compliance had to be shown by reference to a rather inflexible set of checklists. Significantly, any broker or insurer may now develop their own contract certainty compliance and demonstration tools, by reference to checklists, file audits, IT systems or a combination of these.
- 4 Any contract changes must be documented correctly and promptly. From a good practice point of view, many participants would already have been applying contract certainty rules to contract changes, but the Code now makes it explicit that changes must also comply with the Code.
- 5 If there is more than one participating insurer, the contract must stipulate the basis on which each insurer's final participation will be determined, and the final participation must be provided to each insurer promptly.

If any part of the Code is not complied with, the breach must be resolved as soon as practicable and without delay.

The Market Reform Contract

The MRC is, in effect, a template for all insurance contracts. All the information within an insurance policy must be arranged under the correct heading. These headings are Risk Details, Information, Security Details, Subscription Agreement, Fiscal & Regulatory and lastly Broker Remuneration and Deductions. The MRC is intended to increase the ease with which a contract can be considered, negotiated and revised, by standardising the format of such contracts.

However, the guidance notes to the MRC make it clear that it is an explicit aim of the MRC to pave the way for the FSA's next major project, which is to ensure that all contracts in the London market meet the requirements of 'quality' as well as certainty. As a result of the contract certainty rules, parties to an insurance contract can now be certain about what the terms are. However, the FSA is concerned that the policy terms themselves may still be inappropriate, badly drafted, ambiguous or conflicting. The FSA plans to require the London market to address this contract quality problem, although the details of how the FSA will do this are not yet clear.

One other aim of the MRC is to assist in enabling the increased use of electronic trading. The standardised MRC is designed for use with electronic trading platforms as well as for the traditional methods of placing.

What are the implications?

The view of the London market is that the Code will mean that more work on the technical aspects of placement will have to be undertaken before entering into a contract. There will inevitably have to be more time and effort spent on a contract before inception. This front-loading of work to the pre-contractual negotiation stage will also require traditionally back office policy-drafting skills to be deployed from the very earliest stages in the formation of a contract.

It seems inevitable that this change in culture in the London market has the potential to cause some problems between parties in different jurisdictions, especially where a risk needs to be placed urgently. Bermuda already has a reputation for efficient placing processes, but while the London market is still adapting to the new regime, difficulties may arise from a mismatch between the approaches of the different jurisdictions. Accordingly, all insurers and brokers need to be aware that for the moment, business may not be able to be placed in the London market as quickly as it used to. However, it is to be hoped that by allowing the extra time, all parties will enter into a contract where the terms are certain and in which they can therefore have confidence.

The implications of the forthcoming contract quality project cannot yet be fully understood. However, the London market is already taking notice that further regulatory rules can be

³ A term that defines that the cover exists "subject to" a certain condition being met, such as a survey being obtained for insurance of a commercial building.

▶ anticipated and planning ahead accordingly. No doubt many companies will be trying out new procedures to try to ensure that contract terms are always appropriate and non-contradictory, and to avoid the problems that often arise when terms are “cut and pasted” from various templates to create a new contract. It is significant that the London market is attempting to be proactive in the face of potential change, rather than simply reacting to an edict from the regulators. While the regulator has been required to drive change in the past, the London market itself may take the initiative in the future.

Electronic Trading

The benefits of electronic placing have long been discussed. It is commonly accepted that the use of electronic trading could open up opportunities to improve customer service and increase the efficiency of the placing process by using face-to-face placing more selectively – where it really adds value – and by transferring data and documents electronically rather than solely in paper form.

However, until relatively recently, the available platforms to enable electronic trading were not sufficiently sophisticated to allow electronic trading to take place across the London market. Accordingly, the development of electronic trading has been perceived as being rather slow. This seems set to change in the near future with the availability of more advanced trading platforms, and the enthusiastic endorsement of electronic trading by the Market Reform Group. The Market Reform Group has explicitly stated that one of its main aims for its work in 2008 is to increase the (already growing) use of electronic placing and endorsements.

What are the implications?

While the potential benefits of increased use of electronic trading seem clear, the ramifications for disputes that arise out of electronically placed business are less well understood. The number of disputes over exactly what information was communicated to an underwriter may well decrease. However, more disputes could turn on the exact meaning of comments submitted in electronic form. In circumstances where parties more used to conveying meaning verbally are expected to write accurate descriptions under time pressure, it seems likely that many disputes will arise from poor wording. Many companies already recognise the need to train personnel to ensure that written electronic placing is as accurate as the

equivalent verbal broke would have been, but others may be slower to adapt to avoid the new risks of electronic placing.

Lloyd's Minimum (or Franchise) Standards

The Standards

Even while major projects such as the introduction of the Code are taking place, the regulatory landscape is still changing in no less significant ways for specific areas of the market. For managing agents at Lloyd's, the Lloyd's Minimum Standards have recently defined and clarified what is required of them.

The Franchise Standards set out Lloyd's requirements of each managing agent. They represent the minimum level of performance required of any organisation within the Lloyd's market. The Standards are wide-reaching, and cover the areas of Claims Management, Risk Management and Underwriting Management.

Claims management

The Standards set out several requirements, ranging from having a clear claims philosophy to the need for appropriate resources enabling claims to be adjusted in an efficient and timely manner. There are also set requirements for the appropriate documentation of claims, consistent reserving, the selection and use of third parties, and for appropriate and regular management procedures. For subscription business, the Standards also dictate having a claims agreement process to protect the interests of followers.

Risk management

The Standards also set out a need for an organisation's approach to risk management (including on a day-to-day basis) to be effectively communicated, and to adopt a process by which it can identify, assess and mitigate risks as well as monitor its risk profile. There is also a need for the risk management framework to be integrated in such a way to allow management to assess and measure the return on risk.

Underwriting management

The managing agent must have an effective process for challenging the annual business plan as well as effective systems and controls over each managed syndicate's underwriting. The Standards also impose the need for effective systems and controls wherever underwriting authority has been

▶ delegated. The need for appropriate pricing methodologies and effective rate monitoring processes as well as effective systems and processes to monitor underwriting exposures is also set out in the Standards. Furthermore managing agents need to have controls over their reinsurance arrangements, and effective systems for the recording and reporting of data to management and to Lloyd's.

What are the Implications?

The existence of such detailed practice requirements for managing agents at Lloyd's serves as another illustration of the extent to which regulation is now being used to try to raise standards, and promote excellence in the market as a whole. It is too soon to know whether the Standards

will achieve this aim, or to fully understand the practical implications.

Conclusions

As the implications of all these developments become clear, and as the London market continues to evolve, we will publish further updates. In the meantime, we will always be delighted to assist with any more specific questions you may have regarding the London market. And we will always be interested in any comments you have regarding your experience of dealing with the London market as it adapts to the new regulatory regime, so we look forward to hearing from you. Please feel free to contact anyone in our International Reinsurance Team, details below:

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We can put together a seminar/talk or panel discussion on the issue above, or any of the issues featured in our publications to be held at any of our offices, or yours. If you are interested, please contact any one of our lawyers or **David Simon at david.simon@robinsimonllp.com.**

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