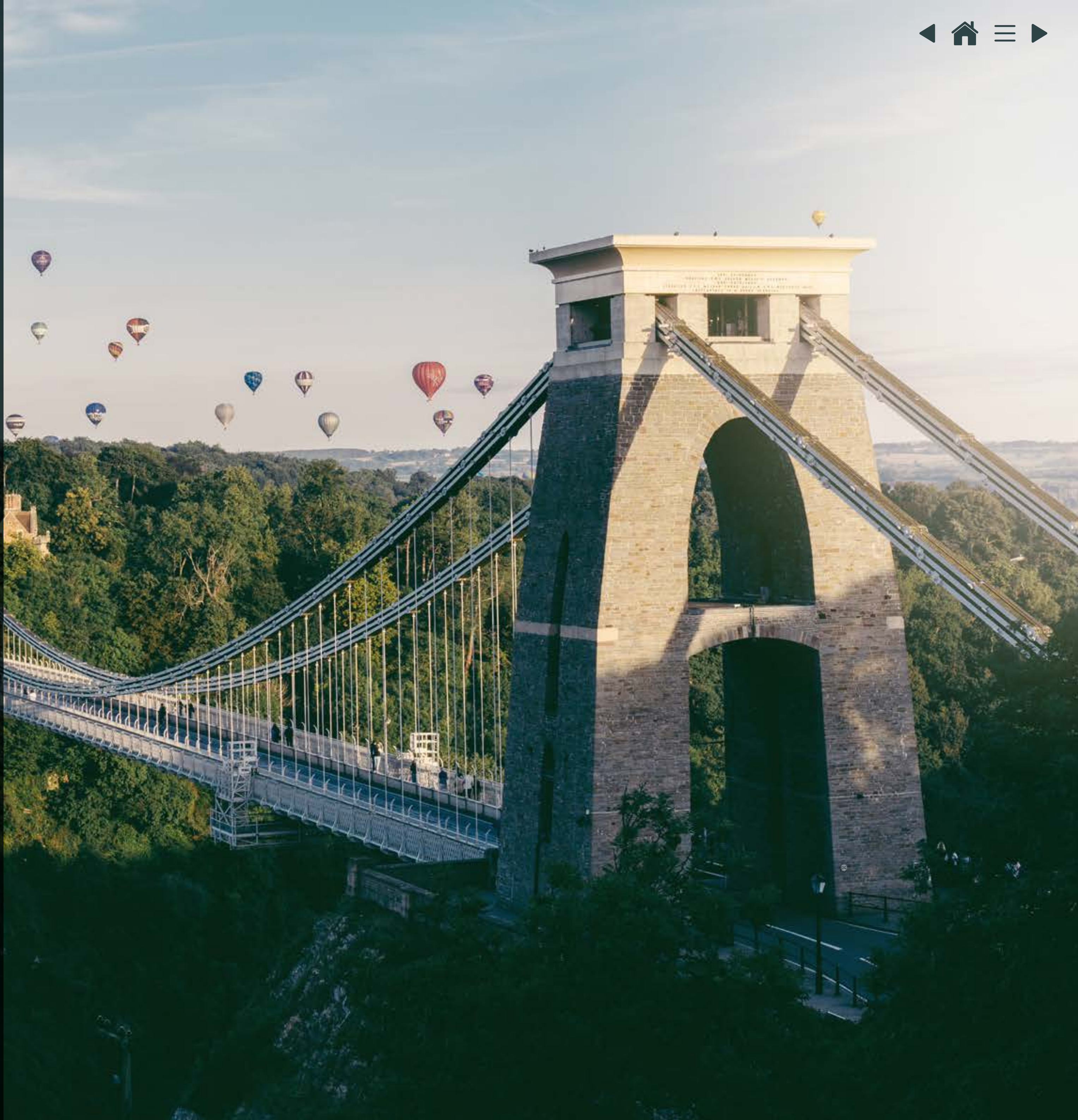
Hogan Lovells

Insurance Horizons

2022-2023

Contents



Introduction

Whilst life is returning to a "new normal" following the global pandemic, there is little doubt that we continue to live in an uncertain and complex business environment. Political instability, inflationary pressures and rising interest rates, the Russian invasion of Ukraine, and regulatory reforms are just some of the significant headwinds impacting the insurance sector.

Added to which, insurers are now dealing with the day-to-day impact of sanctions regimes and cybercrime. But challenging times also provide opportunities, and there will certainly continue to be opportunities during this period. We expect insurers to continue to explore ways to innovate, with many traditional insurers considering acquisitions and collaborations in the InsurTech space, as well as ways to take advantage of the potential of blockchain technology.

In this year's brochure, we have provided our thoughts on some of the key themes that will impact the global insurance sector over the coming months, including in relation to sanctions, ESG, cyber, blockchain, regulatory changes, and trends in the M&A and insurance business transfer markets. We have kept this edition as concise as possible by limiting it to high-level summaries for each topic. If you are interested in learning more about a particular topic, you can follow links to the full articles, which are available on Engage, our thought leadership platform.

We hope you find this brochure helpful, and we would welcome any queries or feedback you might have. Throughout the brochure, you can find key contacts for each of the topics covered, and we encourage you to get in touch to discuss them further.

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Sanctions against Russia

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Around the world, there has been a huge amount of legislative and regulatory activity in relation to sanctions against Russia following the country's invasion of Ukraine. Keeping up with the pace of change is, and has been, a major challenge for businesses which have present and past business dealings involving Russia. For the insurance sector, the position is no different.

The U.S. has implemented far-reaching export controls and economic sanctions against Russia which are having a considerable impact on the insurance industry. Key developments for the industry include: Specially Designated Nationals designations; new comprehensive territorial sanctions on certain regions; potential exposure under the Export Administration Regulations (EAR), including on the export of of "luxury goods"; oil and gas import bans; "new investment" bans; and bans on providing accounting, trust and corporate formation, and management consulting services.

The EU has also used a variety of means through which to increase pressure on Russia, including: additional asset freezes; the expansion of sectoral debt/equity restrictions; and the imposition of broad new trade-based measures. Given the broad nature of these restrictions and the limited nature of the exemptions, these are likely to have a significant effect on participants in the (re)insurance market, particularly when relevant wind-down periods come to an end.

Whilst the UK's approach is largely similar to that of the EU, there are also important differences which make the compliance response all the more challenging. Two of the areas in which we have seen key restrictions imposed in the past year are marine and aviation risks.

It is likely that additional sanctions will be introduced in future, particularly in light of the G7's announcement that they intend to impose further measures in respect of Russia.

Read the full article on Hogan Lovells Engage here.

Toolkit

Sanctions Navigator

Sanctions Navigator provides a practical and straightforward overview of the key international sanctions regimes. It allows you to assess key sanctions risks at a glance, evaluate the impact of sanctions on your business, and keep abreast of the latest developments by receiving insight and analysis from the Hogan Lovells International Trade team.

You can find out more about this toolkit here.

ESG
Time for action

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ESG issues continue to experience a meteoric rise. They are increasingly reshaping the way business operates across a number of sectors, and the insurance industry is no exception.

In the European insurance markets, the ESG landscape is changing rapidly, as firms move to embed ESG principles in their business practices, and there is widespread acceptance of ESG as a critical business consideration. The challenge is clear, with stakeholders and activists showing their desire for swift and positive change, both in the risk and investment spheres. With the regulatory bar in relation to ESG set to increase, the risk of litigation for companies that fail to meet it will also rise. As ESG reporting becomes more established, this too leads to increased claims risks, particularly for D&O lines where the push for greater transparency in relation to sustainability seems set to create significant opportunities for legal claims.

Despite these threats, however, there are clear opportunities for the insurance market, which have the ability to drive positive change through investment activities and underwriting standards.

The picture in the U.S. is less clear, with a patchwork of varying ESG-related policies developing across different states. Some states, such as California and New York, have prioritized ESG issues as they are more commonly understood in Europe, with adoption of TCFD disclosure requirements for insurers and continued scrutiny as to bias issues in the use of "big data". However, other states have taken very different approaches, showcasing the regulatory variance across the U.S. Texas, for example, recently passed a law preventing government agencies and municipalities from doing business with entities that boycott fossil fuel companies.

In Mexico, ESG criteria have been gaining strength as a "soft law" instrument, although the legal framework does not include ESG-specific regulations. Leading global companies have developed corporate rules and published voluntary commitments related to ESG issues, which has caused small and medium-sized companies to join these ESG efforts in order to continue participating as part of the leading global companies' supply chain.

Read the full article on Hogan Lovells Engage here.

Toolkit

ESG Global Vision for Financial Institutions and Insurers

Driven by regulatory change, consumer and investor demand, financial institutions and insurers are making ESG issues central to core strategic decision-making. ESG Global Vision for Financial Institutions and Insurers provides regular, high-quality news analysis from our market-leading team of lawyers, to help you stay abreast of legal and regulatory ESG changes affecting financial institutions and insurers.

You can find out more about this toolkit here.

The cyber insurance capacity crunch

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Cyber insurance buyers have faced a difficult market of late. An increase in ransomware attacks, combined with increased demand for the product amongst corporates, pushed the cyber market into the red, and insurers responded by raising prices – particularly in Europe and the U.S. Higher risk has resulted in fewer insurers offering cyber capacity, and the high rates prompted certain price-sensitive buyers to reconsider purchasing the cover even when offered it. There has also been an increase in high-profile disputes around coverage, particularly in the U.S.

Looking ahead, market movements may decrease insurers' exposure, but it is clear that price increases, higher deductibles, lower limits, and coverage restrictions will be needed to usher in a return to profitability in the cyber insurance market. Insurers will need to pursue this while staying aware of the reality that buyers in this developing market will not accept further price increases.

The market needs long term pricing solutions, beyond the usual "blunt instruments" of exclusions and sub-limits. These may be found in Insurance Linked Securities (ILS) and increased use of co-insurance models. ILS could offer alternative capacity in the same way that it has for many years in the natural catastrophe market. Similarly, co-insurance models manage risk by making the insured responsible for a greater proportion of the exposure alongside the insurer, an approach which insureds may be willing to adopt in the interest of keeping prices down.

Read the full article on Hogan Lovells Engage here.

Blockchain

Identity tokens and insurance

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Insurance industry leaders have become more familiar with a variety of potential use cases for blockchain technology in insurance, such as the implementation of "smart contracts" to promote efficiency and security in the processing of claims. Recently we have also seen the emergence of "identity tokens" as an innovation that could impact the industry.

Identity tokens denote a user's experiences, credentials, commitments, relationships, and other social identifiers. While the structure and the use of identity tokens is in its nascent stages, there are a few ways in which they may influence the insurance industry, both in its traditional form and as the industry may exist in an on-chain economy.

In the near term, identity tokens have readily apparent use cases within traditional insurance markets. They may be used to supplement, or even replace, information that was once only reported by the policyholder itself. Further, once insurers begin pooling that information, new correlations, relationships, and other data relevant to the underwriting process may become salient. Over a longer time horizon, identity tokens may permit insurance programs that are native to a blockchain-based economy to develop and flourish. Identity tokens not only facilitate the emergence, cohesion, and growth of online communities that may, consequently, pool certain risks, but they also offer a means of insuring that any such pool is diverse enough to make insuring that risk economically viable.

Read the full article on Hogan Lovells Engage here.

Toolkit

Digital Assets and Blockchain Hub

Blockchain and distributed ledger technology could revolutionize supply chains, agreements, contracts, currencies and more.

Our Digital Assets and Blockchain Hub brings together our key digital assets knowledge, helping you take advantage of the technology's huge potential and disruptive impact, while avoiding falling foul of ever-developing legal and regulatory requirements.

You can find out more about this toolkit here.

M&A
Trends in Europe

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The M&A insurance sector has been very active this year, consistent with the general increase seen in M&A across all sectors both in number and value, following the wait-and-see attitude and hesitations that accompanied the COVID-19 pandemic. Europe has been at the forefront of this resurgence in M&A.

While certain stakeholders have decided to exit the continental market, others have consolidated their presence. In the meantime, private equity houses have continued to pursue their acquisition strategies. It will be interesting to see how private equity firms respond to higher interest rates. Leverage is fundamental to private equity investment, and higher borrowing costs will reduce potential returns – but equally there will be opportunities for investment as a result of lower company valuations and the insurance industry may be more attractive in a higher rate environment than other sectors.

The appetite for legacy business opportunities has not been dampened either, with transactions generally increasing in size. The drivers behind these transactions remain the same: for sellers, the release of solvency capital and removal of costs risks, for example, arising from legacy administrative and IT systems; and for consolidators, the need for new portfolios as existing business runs off. It is yet to be seen whether the recent statement on the supervision of run-off undertakings issued by EIOPA will result in a slowdown of the number of legacy business transactions or simply in these transactions taking longer to complete.

A number of fundraisings of FinTechs and InsurTechs have successfully completed. Digitalization has resulted in a number of strategic partnerships and the entering into of joint ventures and alliances with regard to new business models. Renegotiation of bancassurance agreements has also resulted in significant transactions.

Historically, economic downturns have led to declines in M&A activity. Some buyers will be put off by the market uncertainty but others will see opportunities as valuations decline, or will want to continue to pursue their strategic plans. There is also the possibility of some distressed M&A involving insurance businesses for which regulatory capital requirements become a challenge. Anyone considering M&A in this market will, however, need to navigate the economic uncertainty.

Read the full article on Hogan Lovells Engage here.

Service

M&A Regulatory Due Diligence Consulting

Our legal and consulting teams work hand in hand, delivering joined up solutions to clients across the financial services industry. Together, they provide efficient and cost-effective regulatory due diligence, allowing you to quickly understand where there may be concerns with an organization. We can tailor our approach to meet your needs, and agree with you on the extent of due diligence analysis which is prudent for the deal.

If you would like to find out more about this service, please do not hesitate to get in touch.

Insurance business transfers

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Insurance business transfers enable insurers to legally transfer blocks of policies and policyholder liabilities to another insurer. This mechanism has, for many years, helped firms achieve legal finality in respect of their businesses, to acquire blocks of business directly rather than only economically through reinsurance, and to reorganize and streamline their group structures to enhance capital efficiencies.

The UK has a strong track record of facilitating insurance business transfers which are international in nature through the Part VII transfer regime. Despite the UK's departure from the EU, the scope to transfer international business by a Part VII transfer remains extensive. In fact, neither the transferor nor the transferee needs to be a UK incorporated insurer. The English court's jurisdiction is engaged, provided the transferred business is carried on in the UK, both immediately before and immediately after the transfer. Where a transferred Part VII policy is not English law governed, the extent of non-recognition issues is something which needs to be considered at an early stage of any proposal. While the position on recognition of Part VIIs in the U.S. is still untested, it is expected that the fact that there is a court process, plus the other protections in place for policyholders, makes it likely that a Part VII order would be upheld in the U.S. under the doctrine of comity.

The U.S. is taking strides to develop similar regimes to Part VII transfers, with Enstar Group Limited completing the first insurance business transfer in the country in 2020, and Randall & Quilter completing a second one in 2021. Although there are questions that remain, including whether a transfer approved in one state will ultimately be respected by other states, over time, we expect these issues to be overcome given the industry's desire to strategically release capital and reduce costs associated with discontinued lines in transactions that provide finality for the transferring insurer.

Read the full article on Hogan Lovells Engage here.

Toolkit

Regulatory Scraper

We have created a new tool – the Regulatory Scraper – which automatically reviews and collates regulatory updates from high-quality data sources. The tool reduces manual review time, provides significant cost savings and can be tailored to your needs. It is relevant, actionable, and provides excellent results.

If you would like to find out more about this toolkit, please do not hesitate to get in touch.

UK regulation

An overview of recent and upcoming changes

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Man the pumps! No rain: Just a deluge of regulation

In the UK, the summer of 2022 will be remembered for many things and for those with an interest in insurance regulation it will stand out for the number of new policies and regulations issued by the government and regulators, all of which will require those involved in the insurance industry to get to grips with new concepts and new approaches, new rules and requirements. Below is an overview of significant legislative and regulatory changes on the horizon.

The Financial Services and Markets Bill: A significant overhaul

Since October 2020, the UK government has been consulting on proposals for reforming the UK's regulatory framework for financial services (the Future Regulatory Framework Review) to accommodate post-Brexit changes and to strengthen the UK's position as a globally competitive financial market. On 20 July 2022, the Financial Services and Markets Bill was introduced to Parliament. Measures in the Bill include provisions to repeal retained EU legislation and to migrate much of that law to the regulators' rulebooks. For the insurance industry, this will pave the way for the government to proceed with its proposed Solvency II reforms. The regulators will be given new rule making powers and a new secondary objective to support the medium to long term growth and competitiveness of the UK economy. The Bill also includes provisions to deal with insurers in financial difficulties by updating existing arrangements and to expand protections for insurers and policyholders. The Bill has reached the Committee stage where it will be examined in detail and amendments considered before returning for debate in the House of Commons.

Consumer Duty: A new approach

At the end of July 2022, the Financial Conduct Authority (FCA) published its final rules and guidance on Consumer Duty heralding a potentially significant shift in the treatment of customers. Firms were given 12 months to get to grips with the new rules for new and existing products and services (24 months for products and services held in closed books). The first milestone firms were given was that by the end of October 2022 firms' boards should have agreed their implementation plans and be in a position to be able to demonstrate that their plans are deliverable and robust enough to meet the new regulatory standards.

Appointed Representatives Regime: Increased scrutiny

The FCA published at the beginning of August 2022 its final rules aimed at improving the Appointed Representatives regime through increased scrutiny of firms when they appoint Appointed Representatives (ARs). The new rules came into force on 8 December 2022, giving principal firms just four months to make sure they will be able to implement the new disclosure and notification requirements. Legislative reform may follow. HM Treasury issued a Call for Evidence which closed on 3 March 2022. It is now considering the responses received and working with the FCA to determine if reform to the AR regime is needed through legislative changes.

UK regulation
An overview of recent and upcoming changes

Solvency II: A lukewarm response

The deadline for responses to HM Treasury's proposals to reform the Solvency II regime and the Prudential Regulation Authority's (PRA) views on changes to the risk margin and matching adjustment closed on 21 July 2022. The government and PRA have not given a timeframe for responding and publishing further proposals. Unsurprisingly, not all responses have been overly enthusiastic. Economic changes such as the rise in inflation and the recent increase in interest rates, concerns around whether the government's aims are achievable and a perception that the EU's own proposals for reforms to the EU Solvency II regime are more favorable than those of the UK should necessitate more discussion with stakeholders before publication of final proposals. But the government is under political pressure to deliver this "post-Brexit benefit" as soon as possible. "More haste, less speed" should be the approach in the UK to ensure maximum benefit for all stakeholders. In the meantime, in the EU the scrutiny of the European Commission's proposals and negotiations is ongoing.

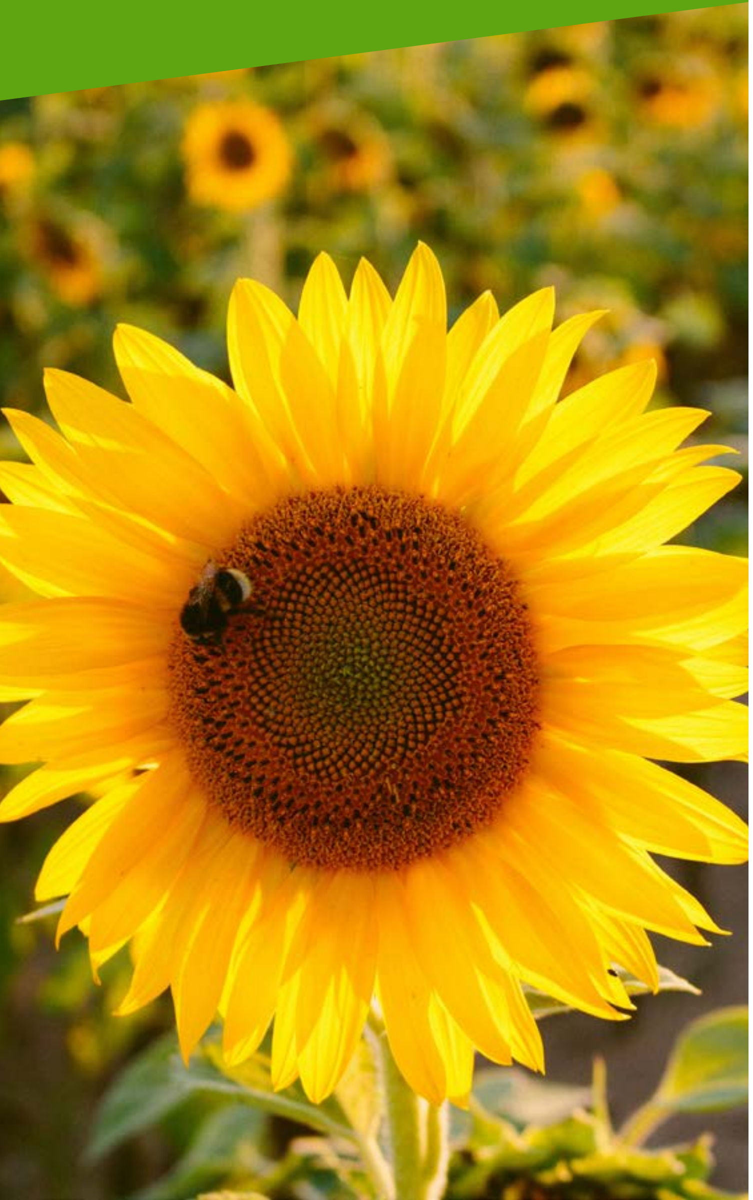
Read our latest insurance regulatory updates by signing up to Engage here.

Knowhow

Insurance Horizon Scanner

We produce a quarterly Insurance Horizons Scanner, which provides a snapshot of key market and regulatory developments expected to impact the UK insurance sector over the coming months. You can receive this free publication, along with our other insurance sector knowledge, by signing up to Engage, our online thought leadership platform available exclusively for our clients. Engage brings together our latest legal, market and regulatory news, industry insights and analysis from across our global network. We also offer a range of cutting-edge digital tools that are available by subscription on Engage Premium.

About Hogan Lovells



Our vision is to be a bold and distinctive law firm creating valuable solutions for clients. Our expertise is well-balanced across practices and jurisdictions allowing us to deliver high-quality, holistic advice. We pride ourselves on our culture, which is ambitious, committed and supportive.

We also have a strong focus on innovation. To us, innovation means a number of things, including:

Helping our clients innovate

We focus on areas where law and regulation are changing, helping our clients realize the potential of a wide-ranging set of developments, market shifts and new technologies, whether that is Big Data, Blockchain or post-Brexit challenges.

We also work to help in-house legal teams innovate and deliver efficiencies within their businesses.

Innovating in how we deliver our services

As our clients' priorities change, we are always looking to enhance our mix of services and the way we deliver them. Part of this involves thinking about ways we can use advanced technology or alternative delivery models but it also involves thinking about the way in which we engage and collaborate with our clients, at all stages of a project, in order to develop new approaches, improve decision-making and maximize value for the in-house legal team.

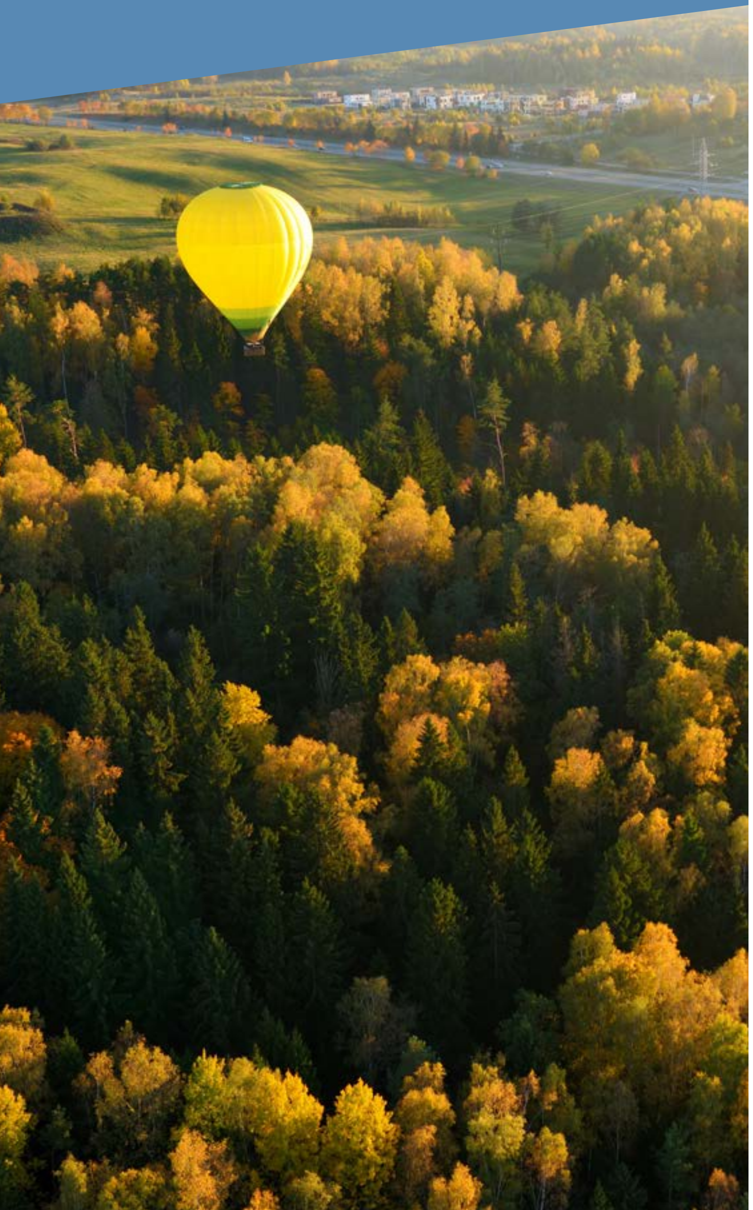
Innovating in how we run our business

Our people are our most important resource. Talent-focused innovation in relation to diversity and inclusion, legal learning, and responsible business initiatives are, therefore, all central to our approach. We also operate an internal innovation hub and business incubator, focused on helping our people to test and develop their ideas.

Hogan Lovells as a responsible business

We are committed to playing a leadership role in driving inclusive and sustainable development in which both people and planet prosper. We contribute to the achievement of the UN Sustainable Development Goals (SDGs) in our own business and we support our clients to do the same through the work of our ESG taskforce. Working collaboratively within our firm, within our communities and society, and with our clients, we use the law to build a better world for all.

Value-added services



Client seminars, webinars and bespoke training

We offer regular seminars and webinars on a range of topics. We also regularly visit the offices of our clients to provide bespoke training on topics relevant to their particular needs and requirements, including digital, compliance and cybersecurity training.

Engage

Engage is the Hogan Lovells online thought leadership platform available exclusively for our clients. Engage brings together our latest legal, market and regulatory news, industry insights and analysis from across our global network. We also offer a range of cutting-edge digital tools that are available by subscription on Engage Premium.

You can sign up to Engage here.

Legal technology

In order to deliver our services as efficiently as possible, we have an extensive suite of legal technology tools that we would be delighted to share with you.

Project resourcing

We can deliver the services we offer to you in a number of different ways to achieve the right balance of expertise and cost effectiveness. These resources include lawyers and paralegals from:

- Our Legal Delivery Centers
- Our partner flexible resource providers, such as Elevate
- Our alumni network

These different resources allow us to provide appropriate and cost-effective support across a range of different types of matters, including detailed document reviews for business reorganizations, product reviews and litigation.

Legal project management

Our extensive experience of working with our clients and executing projects gives us considerable expertise in legal project management (LPM), which we use to improve efficiency and assist our clients with the management of their projects. We have also developed a dedicated internal LPM team in order to identify and share best practice across our different client teams and to provide practical support to fee earners. This helps ensure even the most complex projects can be delivered efficiently and to plan.

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