Technological advancement, regulatory change and market uncertainty have been key themes throughout 2018 and they look set to continue into 2019.

We take a look at the current professional indemnity and financial lines trends and what we expect to see more of over the coming year, including the continuing evolution of cyber risk, key court decisions, regulatory changes, the impact of the current political landscape and shifts in market behaviour.

BREXIT

The UK is at a critical stage in its path towards exiting the European Union in March 2019. Having moved beyond the ‘divorce settlement’ phase of negotiations with Europe, attention is now rapidly turning towards the future relationship between the UK and the EU. Clear conflicts within the Prime Minister’s own Conservative party, coupled with the government’s failure to set out a clear strategy, has resulted in significant uncertainty within the business community.

Respected commentators consider Brexit needs to be sensitive to the global competitiveness of the UK’s insurance sector and UK politicians should remain mindful of the continuing need to put in place ongoing trading arrangements that can provide reassurance to the market.

The passporting regime will end at some point. Once lost, UK domiciled insurers will no longer be able to issue insurance contracts in the EEA.
In the event of a “no-deal” Brexit, it is also possible that insurers will be unable to service existing EEA contracts by settling and paying claims. This could mean the market comes to something approaching a standstill by as early as 29 March 2019.

For now, the UK has, in principle, the prospect of a transition period until 31 December 2020. During any transition period, passporting will continue. This will give the UK and EU time to create a regulatory regime for cross border insurance business.

To avoid the consequences of a possible “no-deal” Brexit, many companies have already chosen to establish new EU subsidiaries. Others (including smaller insurers) have formed relationships with local carriers to ensure they have arrangements in place by March 2019, and are able to underwrite EEA business going forward (even without a transition period).

For EEA insurers, the UK government has (since December 2017) made clear that it will, if necessary, unilaterally introduce a temporary permissions regime. Hopefully, the UK has therefore provided a backstop for EEA insurers in the event that there is no transition period.

The reality is that there remain significant hurdles ahead. On current reading, May faces an uphill struggle in sealing her deal before the end of 2018. Politically, the details of the transition remain awkward.

For insurers, 2019 will see the ongoing execution of contingency plans in order to safeguard commercial interests, whatever the final deal looks like.

Related item: Brexit focus area

**CYBER INSURANCE**

Cyber attacks represent a growing danger that threatens businesses of all sizes, irrespective of sector, and are perceived to be the global risk of highest concern by business leaders in advanced economies. Demand for cyber insurance products has grown and it has been reported that the cyber insurance market is likely to grow from US$3bn of premiums last year to US$7bn by 2020.

Cyber attacks can have potentially enormous repercussions for the businesses involved, particularly if the impact of risks is underestimated. As such, understanding the risks and protecting clients - whilst also protecting their own balance sheets - is going to be particularly challenging for insurers over the next few years and will undoubtedly lead to continued uncertainty in the market.

Insurers and insureds alike with legacy systems built on unpatched and outdated software will be even more vulnerable to cyber attacks, whilst interactive technologies such as telematics, wearables and the Internet of Things provide cyber criminals with new and evolving routes to highly sensitive personal data.

Increased publicity surrounding GDPR and high-profile data leaks has resulted in the average consumer becoming significantly more aware than previously that they may be entitled to compensation. While the quantum for each individual claim is relatively modest, group actions are increasing and the cumulative exposure to multiple claims can easily run into millions (as evident in Various Claimants v Wm Morrisons Supermarkets Plc [2018]). The greatest exposure for both liability and cyber insurers is likely to come from legal costs, but Morrisons at least provided some respite as it was ruled that arguments must at least be pleaded by claimants in a proportionate and focussed way.

Related item: GDPR focus area

**ARTIFICIAL INTELLIGENCE**

AI is increasingly having an impact on daily life and it has the potential to fundamentally alter entire businesses and industries. PWC anticipates that all UK regions will see significant gains as a result of AI by 2030, at least as large as 5% of GDP. With regard to the insurance market, AI has the potential to drive savings for insurers, brokers and policyholders. For example, AI will enable a seamless automated buying experience, using chatbots, which will use customers’ geographic and social data to personalise interactions. In addition, online interfaces and virtual claims adjusters may make it more efficient to settle and pay claims whilst simultaneously decreasingly the likelihood of fraud.

The advancements and application of autonomous vehicles technology will provide helpful insights into how AI will impact the service industry, with changes to legislation and questions over shifts in liability already being addressed.

We anticipate that over the next ten years (and beyond) the development and utilisation of AI
technology will be reflected heavily in the transformation of service delivery models and exposures faced by businesses. For example, RPA (robotic process automation) provides a potential answer for the administratively burdensome aspect of data recording, and CI (cognitive intelligence) provides a potential answer for more developed problem solving.

Related item: Artificial Intelligence: time for Alternative Insurance?

CLAIMS MANAGERS REGIME

The FCA has recently set out how it intends to regulate Claims Management Companies (CMCs) when it assumes regulatory responsibility on 1 April 2019. The FCA is hoping to remove CMCs’ ‘ambulance chasing’ image and instead, present them as “trusted providers of high quality, good value services that help customers pursue legitimate claims for redress”.

Their proposals include the following requirements for CMCs:

- To provide potential customers with a short summary setting out important information about their services
- To conduct due diligence on ‘lead lists’ obtained from third parties for the purpose of gathering information
- To record all calls with customers and keep recordings for a minimum of 12 months
- To hold capital linked to the type of business they undertaken
- To protect client money. The FCA is due to publish the final rules that will apply to CMCs shortly.

The implementation of these proposals will undoubtedly increase consumer protection and in turn, consumer confidence in the market. By the same token, it may drive an increase in insurance claims.

Related item: Claims management companies: the impact of regulatory reform for the industry and for insurers

DREAMVAR

In a surprise judgment late in 2016, Mishcon de Reya was held liable to its client - Dreamvar - in respect of a property purchase in which Dreamvar was defrauded by an unknown third party. Mishcon de Reya was required to indemnify its client, despite an acknowledgement by the judge that it had not been negligent. Mishcon de Reya appealed the finding. However, the Court of Appeal’s judgment has expanded the circumstances in which conveyancing solicitors could be liable to purchasers in sham transactions. The decision raises concerns that conveyancing solicitors and their insurers will effectively be treated as guarantors that property transactions are genuine.

Related item: Dreamvar revisited: the nightmare for solicitors and insurers continues...

#METOO/GENDER PAY GAP

The recent spotlight on gender equality is having an impact on all businesses, regardless of size, nature or geographical location. The widely publicised actions of a number of celebrities have caused global ripples across a broad range of industries which cannot, and should not, be ignored. In most jurisdictions, inappropriate and predatory sexual behaviour towards an individual, employee, or group is not novel. However, the acknowledgement that such conduct is much more prevalent than previously recognised, means that insurers are likely to see an increasing number of claims arising out of sexual misconduct allegations, and the notifications are likely to be impact both Employment Practices Liability and D&O insurers.

Employment Practices Liability and D&O insurers (who routinely provide cover for cases of sexual harassment, wrongful termination and retaliation), brokers and insureds will undoubtedly review the existing cover for employees and persons in managerial positions who may be subject to proceedings - irrespective of whether or not accusations have been made. Moreover, new interest for insurance cover in respect of public relations and crisis management costs may also increase.

There is scope for additional risk and exposure arising out of #MeToo and sexual harassment claims. For instance, the individual perpetrator may become a target for shareholders in respect of breaches of fiduciary duties if their actions have significantly impacted on the value of shareholders’ investment.

Shareholders/investors could also seek to bring proceedings against management personnel for reasons such as failure to undertake adequate due
diligence in respect of a managerial appointments, or for failing to follow procedures to address sexual harassment.

#MeToo has come at a time when workplace equality issues are high on the agenda in UK society, with the development of ‘gender pay gap reporting’ for companies over 250 persons becoming compulsory in April 2018 and high profile political scandals such as the resignation of Defence Secretary Michael Fallon falling under public scrutiny.

Related item: EPL claims: changing norms and new legislation in the #MeToo era

MARKET MODERNISATION

London continues to provide a thriving insurance and reinsurance market for a wide variety of risks. Whilst regulatory developments such as ongoing preparations for Brexit, the impact of GDPR, the Insurance Distribution Directive and the enhanced Senior Insurance Managers Regime will undoubtedly be a top priority for the market in 2019, there will also be a significant focus on market modernisation.

Bruce Carnegie-Brown, the new chairman of Lloyd’s, has stated that the market needs to do more to modernise and to that end, it appears to be undergoing a technological overhaul. This includes the use of new Target Operating Model infrastructure projects which are designed to make the London Market a more accessible and cost-effective place to do business. All entities within the London Market process - policyholders, brokers, coverholders and carriers - will benefit from these changes.

An additional example of collaboration for the benefit of the market as a whole is the recent introduction of the Single Claims Agreement Party (SCAP) which will “enable quick and efficient authorisation of claims by allowing policy leaders to agree non-complex payments up to £250,000 on behalf of following carriers.” This is further evidence of a coordinated approach aiming to enhance market efficiency, thereby widening the appeal of conducting business in London.

Related item: Modernisation of the London Market continues with TOM

CRYPTOCURRENCY AND MONEY LAUNDERING

Cryptocurrencies, as virtual money, are not issued or backed by a central bank or government. They are currently unregulated in the UK (in contrast to the US/ South Korea and Japan). The FCA issued a Consumer Warning on Initial Coin Offerings (ICOs) on 12 September 2017, describing them as “very-high risk, speculative investments” and stated that the majority of ICOs will be unregulated. However, the FCA will consider ICOs on a case by case basis as to whether regulated activities are involved.

The FCA also issued a Consumer Warning in relation to Contracts for Differences (CFDs) or financial spread bets on the value of cryptocurrencies on 14 November 2017. The FCA also described CFDs as “extremely high-risk”. Contrary to ICOs, the FCA does regulate CFDs. Therefore, firms offering CFDs must be authorised by the FCA. However, the FCA warned that only experienced and sophisticated investors should consider investing.

The UK government has recognised the significant risks associated with cryptocurrencies and, in March 2018, made an announcement about a new crypto asset task force for monitoring digital coins and financial technology.

Further, the Fifth Money Laundering Directive (MLD5), which came into force on 9 July 2018 introduced a definition of ‘virtual currency’ and requires relevant institutions to implement financial crime preventative measures. The European Commission takes the view that the new measures will address the money laundering and terrorist financing risks and will have no negative effects on the benefits and technological advances presented by technology underlying virtual currencies. Thereafter, it is likely that there will be a rise in prosecutions for the commission of offences contrary to the Proceeds of Crime Act 2002, Terrorism Act 2002 and the Money Laundering, Terrorist Financing and Transfer of Funds Regulations 2017.

Related item: FCA Business Plan – 2018 update

TERRORISM - CHANGING NATURE OF RISK

Terrorism remains a significant threat to businesses, governments and individuals and there is clear governmental focus in addressing this. Indeed, in response to a series of terrorist attacks in the UK last year, Pool Re, the government-backed insurer, confirmed earlier this year that, as a result of the government’s commitment to amend the 1993 Reinsurance (Acts of Terrorism) Act, companies in the UK affected by future terror attacks will for the first time, be covered for non-physical damage. Other insurers also appear to be willing to expand
the scope of available coverage to address evolving terrorism tactics.

Further, the Home Secretary has recently re-launched the government’s counter-terrorism strategy and introduced the Counter-Terrorism and Border Security Bill. The updated counter-terrorism strategy is said to deal with the unparalleled challenges facing the UK and to ensure that UK laws reflect modern use of the internet, better manage terrorist offenders and permit more effective investigations. The proposed wording of the legislation will be debated in parliament in due course.

Related item: Terrorism - the evolving risk

INSURANCE DISTRIBUTION DIRECTIVE

The Insurance Distribution Directive (IDD) replaced the Insurance Mediation Directive on 1 October 2018. The IDD is an EU wide directive aimed at “levelling the playing field” for insurance intermediaries and insurance distributors and will undoubtedly have profound implications on the market. Whilst the IMD applies solely to the regulation of insurance intermediaries, the new IDD applies to insurance distributors as well and will include all of those who sell, advise on, or conclude insurance contracts, as well as those who assist in administering or performing them.

The IDD is aimed at ensuring harmonisation across the EU and includes:

- Ensuring minimum levels of staff knowledge and ability
- Product oversight and governance
- Remuneration disclosure requirements
- Conflicts of interest disclosure
- Pre-contract disclosures
- Customer demands and needs requirement
- Complaints handling and out of court redress.

Should an EU Member State wish apply a higher standard, then they will be able to do so. Whilst complying with the IDD is likely to be a challenge, it will hopefully present unique opportunities for insurance distributors and intermediaries alike, to review their current processes and enhance consumer protection.

Related item: The IDD – levelling the playing field or simply another administrative challenge for insurers?

A SHIFT FROM THE TRADITIONAL BUSINESS MODEL?

There appears to be a slight shift in the insurance industry from the traditional business model of taking on risk on behalf of customers, to the provision of services. For example, some travel insurers now offer psychologists and trauma nurses to customers following major disasters; insurers such as RSA are providing customers with a programme which enables them to track risks at individual or multiple sites; and cyber policies are increasingly incorporating access to an incident response team as a core part of their offering.

Some core markets are extremely competitive and have been growing minimally over recent years. These difficulties have been compounded by low interest rates and new capital rules. As a result, services are increasingly seen as the solution to these problems and a way to improve customer loyalty.

The FT have recently quoted Mario Greco, chief executive of Zurich, who stated that:

“This is a great opportunity for the industry to become fully understandable for customers, which for years has been its Achilles heel. Customers haven’t understood why they need insurance.”

CLIMATE CHANGE

Climate change is increasingly seen as a threat to financial stability. The increased frequency of weather-related catastrophic events contributed significantly to a £2bn loss for Lloyds of London last year and 2018 and 2019 are likely to be similarly challenging years for the market.

Going forward, it will be essential for insurers to keep up with the changing risk landscape as they will need to continuously assess and mitigate catastrophic risks. The market is using drone technology both to assess risk and survey damage in order to make risk models more accurate.

Customers are demanding ‘green’ financial products and the impact of climate change on financial services and markets has led to both the PRA and the FCA publishing discussion papers on banks’ and
insurers’ approaches to managing the financial risks from climate change, which will continue to shape the conversation into 2019.

Related item: Latest wildfire update - UK perspective

CRIMINAL LIABILITIES

Worldwide, regulatory bodies are moving towards holding corporate entities (as well as individuals) criminally liable when things go wrong. This has seen the advent of the Criminal Finances Act 2017, which came into force on 30 September 2017.

Under this Act, companies and partnerships (and not just individuals) can now be criminally liable if they fail to prevent tax evasion. The Act introduces a host of strict liability offences which will enable prosecutions against entities if an associated person (being an employee, agent or person who otherwise performs services on behalf of that entity) enables or facilitates tax evasion in the UK and abroad. No new tax offences have been created, but the scope for prosecution of existing offences has widened, as evidence of the involvement of a ‘directing mind’ is no longer required.

Related item: The UK Criminal Finances Act 2017: implications for offshore financial providers

TALENT AND TECHNOLOGY

With the progress of technology in both the way we run our businesses, and understanding the businesses that we insure, there is a widening skills gap both in terms of human capabilities and in the systems employed. There is a disjoint between technical knowledge, held by more senior professionals, and technological knowledge, which tends to be held by more junior professionals.

The five most difficult roles to recruit for are said to be analytics, executives, actuarial, technology, and underwriting, which we expect is a reflection of this difficulty. New roles, like Chief Analytics Officer, Analytics Scientist, and/or Data Engineer, are starting to be developed, and we expect this trend to continue.

INSOLVENCY

Since mid-2017 there have been an overwhelming number of high profile corporate collapses and restructures. We are of the opinion that this trend is because the credit insurance market has hit the “perfect storm” of interest rate rises, exchange rate fluctuations, an economic slowdown and a pending Brexit deal. This all leads to a point where insolvency figures are reaching records last seen in the early 1990s. We expect, then, for the high profile collapses to continue for the foreseeable future. This may, in turn, lead to an increase in claims against Directors and Officers and professional indemnity policies as insolvency practitioners/liquidators look to maximise recoveries for creditors.

With many businesses potentially being impacted by non-payment of debts, the market now sees trade credit insurance as an essential part of every business’s contingency planning. The volatile market conditions are likely to lead to premium increases in the credit insurance market and it is equally foreseeable that market capacity for companies, especially those in the retail and construction sectors, may reduce.

Another consideration is the Third Parties (Rights Against Insurers) Act 2010, which came into force on 1 August 2016. The new Act has made it significantly easier for a third party to bring a claim against an insurer when the insured party has become insolvent and, therefore, insurers should expect a continued increase in requests for policy information and the pursuit of claims.

CLADDING

The Grenfell Tower tragedy has inevitably had huge consequences for cladding contractors and their professional services providers, with huge increases in insurance premiums either already quoted or anticipated, specifically in relation to professional indemnity insurance.

Many UK building companies have already notified insurers of possible future claims, leading to fears of a wave of PI claims across the industry, possibly on the same scale as asbestos litigation in the early 2000s.

The UK government has since provided some practical guidance on compliance with the Buildings Regulations via an ‘Independent Review of Building Regulations and Fire Safety’, with Dame Judith Hackitt commenting that existing guidance regarding the regulations are currently too vague and open to misinterpretation.
Consequently, there are widespread concerns within the construction industry of significant legal action and costs relating to the remediation of ‘non-compliant’ exterior cladding materials.

**FURTHER INFORMATION**
To find out more about our services and expertise, and key contacts, go to: kenedyslaw.com

**KEY CONTACTS**

<table>
<thead>
<tr>
<th>Name</th>
<th>Title</th>
<th>Contact Information</th>
</tr>
</thead>
<tbody>
<tr>
<td>John Bruce</td>
<td>Partner</td>
<td>t +44 20 7667 9459 <a href="mailto:john.bruce@kennedyslaw.com">john.bruce@kennedyslaw.com</a></td>
</tr>
<tr>
<td>Paul Carter</td>
<td>Partner</td>
<td>t +44 20 7667 9053 <a href="mailto:paul.carter@kennedyslaw.com">paul.carter@kennedyslaw.com</a></td>
</tr>
<tr>
<td>Fleur Rochester</td>
<td>Partner</td>
<td>t +44 20 7667 9766 <a href="mailto:fleur.rochester@kennedyslaw.com">fleur.rochester@kennedyslaw.com</a></td>
</tr>
<tr>
<td>Brigid Allen</td>
<td>Senior Associate - Foreign Qualified Lawyer</td>
<td>t +44 20 7667 9264 <a href="mailto:brigid.allen@kennedyslaw.com">brigid.allen@kennedyslaw.com</a></td>
</tr>
<tr>
<td>Dónal Clark</td>
<td>Senior Associate</td>
<td>t +44 20 7667 9395 <a href="mailto:donal.clark@kennedyslaw.com">donal.clark@kennedyslaw.com</a></td>
</tr>
<tr>
<td>Laura Hurst</td>
<td>Senior Associate</td>
<td>t +44 20 7667 9159 <a href="mailto:laura.hurst@kennedyslaw.com">laura.hurst@kennedyslaw.com</a></td>
</tr>
<tr>
<td>Elisabeth Ross</td>
<td>Senior Associate</td>
<td>t +44 20 7667 9389 <a href="mailto:elisabeth.ross@kennedyslaw.com">elisabeth.ross@kennedyslaw.com</a></td>
</tr>
<tr>
<td>Serena Jobanputra</td>
<td>Solicitor</td>
<td>t +44 20 7667 9329 <a href="mailto:serena.jobanputra@kennedyslaw.com">serena.jobanputra@kennedyslaw.com</a></td>
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