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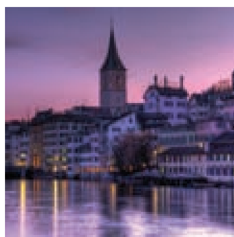
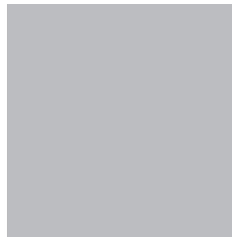
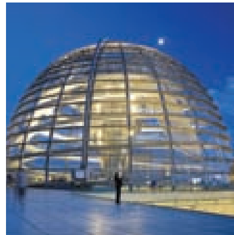
International Insurance LAW REVIEW

May 2011







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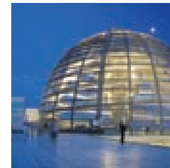

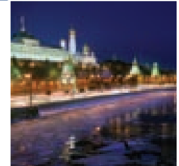

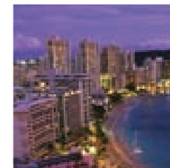

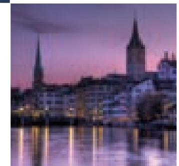

Comment

SENIOR INSURANCE and reinsurance executives are divided over whether emerging or established markets offer the greater future growth potential for their respective businesses.

But regardless of the strategy eventually deployed, it is vitally important that practitioners ensure they are familiar with the appropriate risks, rules and regulations associated with underwriting a whole manner of risks across different territories.

For while the old adage that the insurance industry is very much a global business is, of course, true, a number of nuances and not-so-subtle differences exist across borders.

This year's International Insurance Law Review, once again produced in association with Barlow Lyde & Gilbert LLP, provides an indispensable guide to recent significant legal and market developments across key insurance jurisdictions – both young and old.

More importantly, the guide also examines the possible implications particular judgments and rulings could have on those transacting insurance and reinsurance in the featured territories. The insurance industry seemingly has an insatiable desire for better management information and data and, of course, this becomes even more important when conducting business in locations which are not carriers' "home" jurisdictions.

This law review addresses a number of issues that stakeholders can expect to encounter as they embark upon future business endeavours around the globe.

However, it is important to stress that this guide is in no way a substitute for formal legal advice.

Nevertheless, please ensure you make use of the further internet resources available, which are outlined in this guide.

A number of useful web links have been included which will enable you to keep up-to-date with the latest developments concerning any ongoing issues.

I trust you will find them most instructive. ■

Greg Dobie
Managing Editor, Insurance Day

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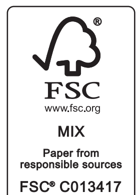


International insurance law review

THE LAST 18 MONTHS have been a tumultuous time for the world we live in and indeed for the insurance and reinsurance industry worldwide.

Insurance and reinsurance are, by their very nature, international. We are often called upon to advise clients across international boundaries. The aim of this guide is to focus on the legal implications arising in different international jurisdictions from key issues or challenges affecting the major insurance markets.

The insurance industry is gearing up to implement Solvency II. The results of the Fifth Quantitative Impact Study (QIS5) were published on March 14 and show that the European insurance and reinsurance sector is in a solid financial position when measured against the Solvency Capital Requirement (SCR) set out in Solvency II.

Despite the ongoing difficult market conditions, outlined further below, the insurance companies which took part in the study are significantly over-capitalised in terms of meeting both their SCR and Minimum Capital Requirement (MCR).

The European Commission is currently consulting on policy issues relating to level-two implementing measures, which will provide the technical detail to elaborate on level-one principles.

Its proposals in this regard will take into account the findings of QIS5. From its analysis of QIS5 results, the European regulator, EIOPA has identified areas where additional guidance is required and where the proposals made are too complex or unrealistic and therefore need to be considered further prior to implementation.

> "The aim of this guide is to focus on the legal implications arising in different international jurisdictions from key issues or challenges affecting the major insurance markets"

Other areas not tested, and which require industry consideration pre-Solvency II implementation, are risk management, governance and reporting requirements.

The industry continues to be concerned about implementation of Solvency II and indeed, recently the European insurance and reinsurance federation (the CEA) sent a letter to the European Commission written by it, the Pan-European Insurance Forum (PEIF), the CFO Forum and the CRO Forum. The letter outlines the need to move away from the overly-cautious approach being adopted in the existing level-two text and requesting resolution of the industry's concerns by this summer.

Alongside the policy issue consultation, the European Commission has also launched the second Europe-wide stress test for the insurance industry. This deals with three alternative stress situations and seeks to quantify the impact of each with a view to assessing the stability of the industry overall and the strength of institutions on an individual

basis. Ongoing review of the Insurance Mediation Directive (IMD) continues.

CATASTROPHE ACTIVITY

The effects of the global economic crisis continue to be felt and, against this background, the world has suffered a series of disasters, both man-made and natural, which considerably impact the insurance sector globally.

In terms of natural disasters, there have been earthquakes in Chile, New Zealand and, most recently and most catastrophically, in Japan, where the nation has been devastated by the earthquakes and ensuing tsunami and nuclear power station shutdown.

Additionally, 2011 had barely started when Queensland Australia was stricken by unprecedented flooding causing the Insurance Council of Australia to put together a 10-point plan to look at possible reform of the disaster insurance industry.

CIVIL UNREST

Meanwhile, at the time of writing, civil unrest continues apace in the Middle East and North African (MENA) region. The extent to which coverage exists for losses due to the events in this region will be determined on examination of the type of coverage purchased and the nature of the exclusions to which that coverage is subject.

Many "all risks" property policies and certain other types of cover exclude losses arising from terrorism and political violence. Often these types of exclusions are extremely widely drafted.

Some, or all, of such excluded perils are instead covered by the market in political risks. There will be considerable debate about losses incurred in the MENA region and whether the peril is covered or excluded, especially in light of the fact that it seems many insureds in the region lack comprehensive insurance cover having instead purchased "terrorism" cover.

Another significant development in Europe has been the ruling by the European Court of Justice (ECJ) in the *Test-Achats* case that gender may no longer be a factor in rating insurance risks. In the light of this decision the insurance industry faces some very difficult adjustments to radically revise insurance pricing as we know it.

Whilst in an overview of this nature, it is not possible to offer definitive guidance or analysis of the topics covered, we hope that, with the kind assistance of our international contributors, we have assisted in highlighting the legal challenges facing the international insurance markets in the coming months. ■

Simon Konsta
Senior Partner
Barlow Lyde & Gilbert LLP, London

Japanese quake and tsunami

Claims have already started to reach the UK and Europe in the wake of the Tohoku catastrophe and more are expected to follow. The sheer magnitude of the event could also spur an increase in the use of alternative forms of risk transfer

THE ALMOST INCOMPREHENSIBLE human tragedy in Japan makes any economic analysis seem beside the immediate point.

However, the first order of business will be to provide the survivors with basic living needs and, after that, the fact of the matter is that parts of Japan will have to be rebuilt, almost from scratch, which will require a tremendous effort from a wide variety of industries, including insurance.

CLAIMS REACHING THE UK

The early estimates are that the bulk of the economic losses are either backed by the Japanese government or, for example, like the damage resulting from the collapse of the nuclear power plant in Fukushima, are uninsured, meaning that the aggregate insured loss will be manageable.

However, claims are now reaching the UK, and law firm Barlow Lyde & Gilbert LLP is already dealing with claims from European insurers, and expects that there will be more.

The sheer magnitude of the event, in addition to the volatility of weather around the world, is likely to have an upward impact on rates and, as the event reminds everyone what could actually happen, could spur increases in alternative risk transfer of catastrophic risk such as catastrophe bonds.

Rate increases are on the way after the Japanese quake

PROPERTY AND BUSINESS INTERRUPTION

Reinsurers expect to incur serious losses as a result of property and business interruption claims triggered by the earthquakes and the tsunami.

However, the Japanese national property insurance programme for private homes is mainly not reinsured by the international players.

In most European jurisdictions the domestic insurance sector is not impacted. Several of the big reinsurers have estimated huge losses - Munich Re estimates its losses to be in the region of €1.5bn (US$2.17bn) and Axa, the French insurance group, has sustained huge costs amounting to hundreds of millions of euros due to its extensive Japanese coverage (five million clients and 8,000 agents). ■

MENA in turmoil

The changing nature of political risk necessitates continual re-examination of policy wordings to ensure they remain "fit for purpose" and state in the clearest possible terms the cover that underwriters intend to provide and insureds intend to purchase

WHEN UNEMPLOYED street vendor, Mohamed Bouazizi, set fire to himself in front of a local government office in the Tunisian town of Sidi Bouzid in December last year, he also lit the touchpaper for a wave of unrest which has swept across the Middle East and North African (MENA) region.

At the time of writing, the situation in the region remains fluid and unpredictable. Events include:

- mass protests in Tunisia leading to the resignation of President Ben Ali on January 14, 2011 and of the interim Prime Minister, Mohammed Ghannouchi, on February 27
- a series of demonstrations, marches and acts of civil disobedience in Egypt, leading to the resignation of President Hosni Mubarak on February 11 this year
- Libyan protests dividing the country with Colonel Gaddafi's government and army engaged in combat with Libyan "rebel" forces
- The eruption of both violent and non-violent protests across the region touching Bahrain, Jordan, Yemen, Algeria, Iran and others.

DAMAGE AND DISRUPTION

These events have led to considerable property damage and disruption to trading and investment projects across the region.

Losses are expected to be significant. Businesses and investors are counting the cost and wondering how long it will take for matters to return to a degree of normality.

Those businesses and investors, and their insurers and reinsurers, will also be scrutinising the terms of their insurance policies to see whether, and, if so how, those policies will respond. The differing nature of the disturbances across the region will mean that the correct classification will be particularly important in determining whether coverage is available or not - the type of coverage purchased and the nature of the exclusions to which that coverage is subject need to be considered when assessing losses.

INSURANCE TARIFF IMPACT

The increased political risk and the risks attaching to civil unrest are likely to lead to an increased demand for insurance and a corresponding increase in insurance tariffs.

The question is where the tipping point will come – for example, when will insurable risk become uninsurable? If volatility increases to a point where the insurance industry cannot price it, insurance may become unavailable entirely or there may be widespread exclusions from coverage.

As well as business interruption and property insurance, export credit and investment insurance and reinsurance are the lines of business most likely to be affected. In addition, there may be an impact on kidnap and ransom and key personnel insurance and reinsurance, which may suffer losses. ■

ECJ gender ruling

The next task for the insurance industry will be to prepare for a possible ban on age discrimination. In the face of this judgment, it is not at all clear that any derogation based on statistical evidence will be allowed to detract from the prohibition of such discrimination

On March 1, 2011, the European Court of Justice (ECJ) gave its ruling in the *Test-Achats* case. The case stemmed from a challenge from the Belgian consumer association, asking whether the exemption in **Article 5(2) of Directive 2004/113/EC** which permits insurers to use gender-related factors in determining benefits and premiums under insurance policies, is compatible with the prohibition on discrimination on the grounds of gender enshrined as a fundamental right of the European Union.

The ECJ has ruled that the Article 5(2) exemption is invalid and has granted a transitional period of relief from implementation – however, from December 21, 2012 it will be unlawful for insurers to apply differentiated terms on the basis of gender in the provision of insurance services.

UK, GERMANY AND FRANCE

The impact of the judgment will be felt most keenly by motor and life insurers and in annuities. In both motor and life insurance, it is likely that women's premiums will increase and men's decrease.

In contrast, where pension annuities are concerned, men will be worse off as they currently benefit from higher annuity rates due to their generally shorter lives.

In view of the transitional period, insurers have to decide individually whether or not to move now to gender-neutral pricing or to delay.

If during the transitional period business continues to be written on a gender-biased basis, domestic law may require the insurers to adjust premiums payable after expiry of the period on a gender-neutral basis.

NETHERLANDS

Gender-based differences in insurance premiums and benefits have been prohibited for some time in most insurance products, including motor and income protection.

However, the ruling will have an impact on individual life insurance companies for whom it will be unlawful to use gender-based factors in pricing policies.

Insurers face an administrative burden as they now have to make new risk and premium assessments and change their products.

SWITZERLAND

Although the Swiss market is not directly affected by the ECJ ruling, gender discrimination is a very topical and controversial issue.

Gender pricing is prohibited in mandatory private health insurance but is standard practice in life, pension and car insurance.

The Swiss Insurers Association has stated that a general introduction of unisex tariffs as a consequence of the ruling, would be "unfair". Its view is that equal treatment requires the use of the same criteria in premium calculation but not necessarily the same premium. ■

Solvency II implementation

Solvency II continues to be a major issue for the industry with insurers and reinsurers focusing on ensuring they are compliant with the European regulatory directive

ON MARCH 14, European regulator EIOPA published the results of QIS5 - this had sought to assess the practicability, implications and impact of specified approaches to reinsurers' valuation of assets and liabilities as well as capital settings under Solvency II.

Approximately 33% more insurers participated in QIS5 than in QIS4 with nearly 70% of all insurers and reinsurers within the Solvency II remit taking part. Most European insurers and reinsurers show a sound financial standing when assessed against the Solvency Capital Requirement (SCR) set down in Solvency II. For example, only 10 Spanish insurers would not meet the SCR. EIOPA has commented that this shows the sector is in a strong position since the capital surplus was attained in the face of difficult market conditions.

ACROSS EUROPE

In the Netherlands there are fears that small or specialist insurers may face problems: insurers may become less flexible and responsive to market needs; and high capital requirements will ultimately impact on consumers because premiums will be increased.

In Germany, smaller insurers and mutuals are worried due to increased capitalisation and bureaucracy and the additional administrative burden of compliance which they are afraid they will not be able to meet.

Meanwhile, in France, the QIS5 survey has highlighted shortcomings, for example, the excess of calibration of certain risks.

Even if only a small number of the French companies evaluated have insufficient coverage, this will still entail significant change and adjustment over the coming months.

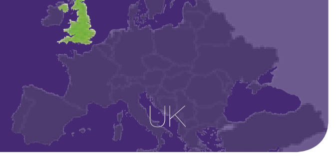
THE UNITED STATES

From a US perspective, it seems unlikely that the United States, in its capacity as the world's largest insurance market, will not achieve Solvency II equivalence (although already many areas of substantive equivalence exist).

US regulators and the insurance industry must continue to be engaged with Solvency II and, perhaps, may even need to ramp up their involvement, not least in the face of the development of International Financial Reporting Standards and the fact that a significant part of the US insurance market is not global, meaning it may not be feasible to have two regulatory schemes co-existing.

Following on from this, on March 23 stress test specifications were published for the insurance sector by the European Commission.

The stress test will be conducted, in cooperation with the respective national supervisory studies, between now and the end of May and will be based on 2010 financial results. In addition, ongoing review of the Insurance Mediation Directive continues. ■



Legal changes and litigation trends

THE ISSUES: What have been the significant legislative decisions of the past 12 months? How will recent heavy catastrophe activity impact the number of disputes across the sector?

THIS YEAR WAS ALWAYS PREDICTED to be a difficult year for insurers and reinsurers. Despite a 2010 littered with natural catastrophes such as the Chilean and New Zealand earthquakes and the Australian floods, over-capacity in many insurance and reinsurance markets remains.

Premium rates therefore remain low and, with investment returns still poor, the financial pressures faced by insurers and reinsurers are growing. The continuing effect of the global credit crisis cannot be ignored. The UK economy is faced with increasing inflation and higher interest rates, all of which will affect insurers and reinsurers alike. Significant legal changes being introduced in 2011 increase the financial burden on insurers still further.

THE SOLVENCY II REALITY

Solvency II was dismissed for years as unlikely to happen, or as having little impact once the European legislative process had taken its toll. But last year saw insurers and reinsurers face the reality that Solvency II really was on its way, and it was going to be significant.

This year will see insurers and reinsurers continue to focus on ensuring Solvency II compliance. On March 23, the European Commission published stress test specifications for the insurance sector. There is a short time frame for responses, from which further guidelines will be developed.

Solvency II also required the European Commission to revise the Insurance Mediation Directive. Although the deadline for such revision was the end of 2010, review by the Commission continues.

Of significant interest is the proposal that direct sales, including those made by one insurer on behalf of another, are caught by the new legislation, as well as proposals for mandatory disclosure of commission levels to customers.

The introduction of the European regulatory directive is also expected to signal the resurgence of the legacy or run-off sector. The extent to which Solvency II will force insurers and reinsurers to dispose of legacy portfolios and unprofitable or non-core books of business remains to be seen, but 2011 is expected to witness a growing number of portfolio disposals.

EU ANTI-DISCRIMINATION LAWS

Staying with the European theme, in February of this year, the European Court of Justice (ECJ) published its decision in *Association Belge de Consummateurs Test-Achats ASBL & others*.

The ECJ upheld the earlier recommendation of Advocate General Kokott in ruling that **Article 5(2) of the European Gender Directive (004/113/EC)** is unlawful on the basis that it is contrary to the EU's fundamental principle of equal treatment between men and women.

Article 5(2) permitted insurers and reinsurers to discriminate between men and women in calculating premiums and benefits, provided this could be backed up by sound statistical data.

From December 21, 2012, insurers will no longer be allowed to discriminate based on gender. This will significantly impact motor and life insurers, as well as the sale of annuity products, and indirect discrimination is also forbidden.

One issue that remains open is the question of to what extent the ECJ ruling binds reinsurers. Clearly, reinsurance is an international business, so those reinsurers outside the EU are not directly affected. In any event, there remains doubt that reinsurers within the EU are affected, but whether this will give rise to gender-specific reinsurance products remains to be seen. Many life and motor reinsurance products are directly linked to the underlying business, so it is currently difficult to see on what basis reinsurers can offer gender-based reinsurance products.

Of importance will be the European Commission's response as regards age and disability discrimination in insurance products. The European Commission is reportedly considering further directives with similar carve-outs to Article 5(2) of the European Gender Directive.

In light of the ECJ's decision, it is questionable whether these carve-outs can continue, raising the question as to whether insurers will in the future be allowed to discriminate on the basis of age and disability.

NATURAL CATASTROPHES

By the end of Q1 2011, insurers and reinsurers have already endured a number of significant natural catastrophes. Even as the year started, the Australian flooding and cyclone crisis was continuing, raising issues of aggregation and policy allocation. How many events? When did the loss start? Is it properly allocable to the 2010 or 2011 years of account?

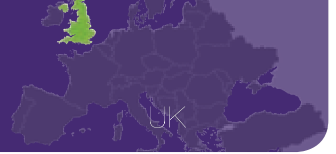
No sooner had these questions been asked, than the New Zealand earthquakes struck. The financial ramifications of the New Zealand quakes are still being measured, but initial indications are that they will be significant.

Growing civil unrest in much of the Middle East and North Africa has put political risk and property insurers on notice of the potential losses to come. And, at the time of writing, the horrific impact of the Japanese tsunami is just beginning to be understood. With such a difficult start to 2011, it is not clear what the rest of the year holds, but analysts are predicting 2011 as the year (statistically speaking) for another major hurricane to strike the Gulf of Mexico region.

These events continue to put pressure on the international reinsurance markets. Yet, it is reported that the losses so far are not significant enough to herald a new hard market with increased reinsurance rates. And if that is right, reinsurers will have to contend with continuing soft rates coupled with the increasing cost of claims. The natural catastrophes have in recent years focussed on aggregation of underlying losses. The fact-sensitive "number of events" question will dominate discussion and potentially fuel a rise in reinsurance disputes.

THE BRIBERY ACT

Back in the UK, **the Bribery Act 2010** will be implemented in July 2011. The Act creates four new offences, with tough penalties of up to 10 years imprisonment and unlimited fines. Of most significance to insurers and reinsurers



LITIGATION TRENDS

LITIGATION TRENDS

Finally, it seems certain that some of the recommendations contained in Lord Justice Jackson's review of civil litigation costs will be implemented...

THE RECOMMENDATIONS PROPOSED radical reform of costs rules (including on conditional fee arrangements), and may signal an end to spiralling personal injury and motor claims.

Lord Chancellor Kenneth Clarke confirmed that the Government would be taking forward proposals to stop winning parties who are bringing claims under Conditional Fee Agreements (CFAs) from recovering any percentage uplift on fees and after-the-event (ATE) insurance premiums from the losing party.

Conditional fee arrangements also received criticism by the European Court of Justice (ECJ) recently. In *MGN v United Kingdom* [2011] **ECHR 39401/04**, the ECJ found that the requirement by the UK House of Lords (now the Supreme Court) for Mirror Group Newspapers (MGN) to pay success fees constituted an interference with MGN's right to freedom of expression. The case concerned the publication of photos of Naomi Campbell by the Daily Mirror in 2004.

The House of Lords ordered MGN to pay a success fee. The ECJ criticised the current regime for conditional fees as being able financially to blackmail parties into settling cases early through fear of increased legal costs.

BRUSSELS REGULATION

The European Commission is also considering ways to increase the efficacy of choice of law/jurisdiction agreements and the interface between arbitration and court proceedings.

In December 2010, the European Commission published proposals to reform the Brussels Regulation (**Counsel Regulation EC Number 44/2001**). The Commission has expressly acknowledged that under the current rules, if proceedings are brought in a member state in breach of an exclusive law/jurisdiction clause, the courts of that member state must first determine the issue.

Courts of another member state cannot injunct the first set of proceedings. This applies equally where court proceedings are commenced in breach of an express arbitration agreement.

The Commission is proposing that where there is an exclusive jurisdiction clause for a particular member state, proceedings brought in any other member state must be stayed until the chosen member state court has ruled upon its own jurisdiction.

This proposal would also extend to arbitration (thereby clarifying the ECJ decision in *Allianz SpA v West Tankers* (**Case C185/07**).

The West Tankers ruling centred on a claim brought by Allianz SpA. The insurer sued the British shipping company in an Italian court after a ship it leased crashed into a jetty in Sicily.

West Tankers subsequently sought an injunction from the High Court in London to halt the proceedings, arguing that its lease allowed for any disputes to be resolved by an arbitration tribunal in the UK.

Although the High Court granted the injunction, the case was later referred by the House of Lords to the ECJ, which rejected the use of anti-suit injunctions and ruled that it should be up to the Italian court to decide whether it had jurisdiction to hear the case.

is a corporate offence, which places a burden on corporations to ensure they have robust procedures in place to prevent bribery. It will impact upon remuneration between insurers and brokers, entertaining and, invariably, upon D&O insurance (since the Act will extend criminal liability to senior officers who have consented to or connived with the offence).

OTHER REGULATORY CHANGES

Following the election in 2010 of the Conservative/Liberal Democrat coalition government, one of the first key government messages was tougher regulation, backed by a tougher regulatory body.

As has been well documented, responsibility for regulation of financial services moves from the Financial Services Authority (FSA) to the Bank of England.

Plans released in February 2011 include oversight being granted to a new Prudential Regulatory Authority which will directly regulate insurers. The government has also announced the creation of a Financial Conduct Authority championing consumer issues, again directly impacting the insurance sector.

Specific plans for the disbandment of the FSA will be released later in 2011, although it is unlikely that the actual transfer away from the FSA will happen before 2012. It is however likely that the new European insurance regulator, the European Insurance and Occupational Pensions Authority (another by-product of the financial crisis) will scrutinise more closely the actions of individual European state regulators to ensure consistency within Europe. ■

WEB RESOURCES

Tougher financial regulation
www.hm-treasury.gov.uk/fin_stability_regreform_index.htm

The Jackson proposals
www.justice.gov.uk/consultations/docs/jackson-report-government-response.pdf

The view in Brazil is that the changes introduced clearly benefit "local" companies, particularly those with no offshore affiliates

A change in resolutions

THE ISSUES: Less than three years after opening-up the Brazilian reinsurance market, the country's government has decided to review its decision in what many see as an effort to keep large reinsurance risks such as the fast-approaching World Cup and Olympic Games inside Brazil

WHEN THE BRAZILIAN GOVERNMENT took the decision to bring to an end state control of the country's reinsurance market in 2008, the new regulations it subsequently issued had already been amply discussed.

However, when it issued two further resolutions, 224 and 225, published by the National Counsel of Private Insurance (CNSP) on December 6, last year, it largely took the market by surprise, as they had not been preceded by any form of debate or consultation.

These resolutions introduce significant changes to the reinsurance and retrocession legal framework set by **CNSP Resolution 168**, which previously governed how reinsurance and retrocession may be offered by foreign companies in respect of Brazilian risks.

Resolution 168 was published pursuant to **Law 126/2007**, which marked the opening of the Brazilian reinsurance market after 69 years of state monopoly.

One strongly expressed view is that these changes are likely to create a negative image for the Brazilian market and

discourage foreign insurance investment in Brazil.

A CHANGE IN POSITION

Under **Article 14 of Resolution 168** a cedant was able to reinsure its risks with any reinsurer it wanted to, subject only to "legal and regulatory requirements".

CNSP Resolution 224 sought to add a new paragraph to this article as follows: "the insurance, reinsurance or retrocession responsibilities [risks] taken in Brazil shall not be transferred to linked companies or to companies within the same financial conglomerate [of the cedant] based abroad".

However, the Brazilian government, through the implementation of **CNSP Resolution 232**, has revoked Resolution 224 and its imposition of a strict ban on the transfer of Brazilian insurance, reinsurance or retrocession risks to linked companies or companies within the same financial conglomerate based outside Brazil.

The new rules, set out in CNSP Resolution 232, allow the transfer of up to 20% of the premium of Brazilian risks to linked companies or companies within the same financial conglomerate based outside Brazil.

LINKED COMPANIES

Linked companies are defined by CNSP Resolution 232 as being those that have:

- direct or indirect participation of 10% or more in each other's capital
- direct or indirect participation of 10% or more, through the administrators or their relatives, together or separate, in each other's capital
- direct or indirect participation of 10% or more, by one company's shareholders, together or separate, in the capital or net assets of the other company.

CNSP Resolution 232 defines a financial conglomerate as a group of financial institutions, insurance companies, capitalisation companies and private pension entities, directly linked or not, by shared ownership or effective operational control, characterised by joint administration or management, or by acting in the market under the same brand or trade name.

The new regime does not apply to surety, internal credit and export, agro risks and nuclear risks. No restrictions now apply to the reinsurance or retrocession on these classes of risk to parent companies outside of Brazil.

IN FORCE

The new rules came into force on March 31 and apply to arrangements currently in force with automatic renewals on the date of the next renewal or March 31, 2012, whichever occurs first.

Resolution 224 was due to come into force on January 31. However, following government intervention it was postponed.

The recent changes, brought in only a few days before the coming into force of Resolution 224, were influenced by lobbying from Brazilian insurance and reinsurance companies, as well as some international reinsurance organisations such as the Federation of European Risk Management Associations (FERMA).

FERMA's president, Peter den Dekker had urged the Brazilian government to review its position and reconsider not only Resolution 224 but also Resolution 225.

CONSEQUENCES OF THE CHANGE

CONSEQUENCES OF THE CHANGE

PREVIOUSLY REINSURANCE and retrocession operations in Brazil could only be carried out by licensed reinsurers which fell into one of the following categories:

- **Local Reinsurer** – based in Brazil as an open shares' company with a minimum capital of R$60m (US$35m)
- **Admitted Reinsurer** – based abroad but with a representative office in Brazil, minimum net assets globally worth at least US$100m and a bank deposit in Brazil of US$5m as collateral for their operations
- **Occasional Reinsurer** – based abroad with no representative office and no collateral deposit in Brazil. Access to risks is limited because local insurers cannot cede more than 10% of their annual premium to this category of reinsurer.

The majority of foreign insurance companies in Brazil are licensed as admitted reinsurers. The change in rules will largely affect them. The view in Brazil is that the changes introduced by the new regulations clearly benefit local companies, especially those with no offshore affiliations.

The idea behind the changes appears to be that admitted reinsurers will be forced to become locals. However, foreign companies will want to think twice before investing R$60m in Brazil if they are not then allowed to retrocede the risks to their parent company abroad.

The changes also seem to go against one of the pillars of reinsurance which requires risk to be spread between different markets and companies in order to minimise the concentration of losses.

It is also unlikely that foreign reinsurers, operating with a local reinsurer's licence, currently have enough capital in Brazil to retain more risks in the country and the question will be asked by many whether the Brazilian market is attractive enough to justify concentrating a significant amount of capital here.

The 40% ISSUE

Article 15 of Resolution CNSP 168 stated that after January 2010 the insurance company shall preferentially offer to a local reinsurer at least 40% of the ceded premium followed by six paragraphs dealing with the preferential offer mechanism. This preferential offer mechanism had to be followed before this percentage of the ceded premium could be offered to other categories of reinsurers (admitted and occasional).

Further to the passing of **Resolution 225, Article 15** now reads "the insurance company shall contract with local reinsurers at least 40% of each reinsurance retrocession in automatic [treaty] and facultative contracts". The six

paragraphs which dealt with the preferential offer have been deleted.

Practically this means that, while it will no longer be necessary to make a preferential offer of 40% of the ceded premium to the local market; there will need to be an automatic and mandatory placement with local Brazilian reinsurers of 40% of the risk.

Another change introduced by CNSP Resolution 225 amends **Article 39 of CNSP Resolution 168**. Article 39 previously stated that "the participation of the reinsurer in the adjustment of claims can be set out [in the contract] without prejudice to the insurer's responsibility to the insured".

CNSP Resolution 225 adds a paragraph to Article 39 which says that "reinsurance contracts, automatic [treaty] or facultative, may contain a claims control clause in favour of the local reinsurer, when it retains a larger share of risk".

REACTIONS AND POSSIBLE LEGAL CHALLENGES

The CNSP is part of the Brazilian Treasury Department which belongs to the executive power. Comments from the market have suggested that, by issuing these two resolutions, this department may have gone beyond its administrative remit as a regulator of the market.

There is also a view that the new regulations have no connection to a specific legal provision and that, by introducing the regulations, the CNSP has usurped the law-making powers which, according to the Brazilian Constitution, only vest in the legislature and cannot be delegated. There are also various other legal arguments which call into question the validity of the regulations.

At present it is too early to see how things will evolve. As already discussed, the resolutions only came into force on March 31 following postponement of enforcement by the government, which could be seen as an indication that the CNSP might be reconsidering its decision.

Although Resolution 225 remains fully in force, for the time being at least, the "toning down" of the restrictions on the transfer of reinsurance/retrocession risks to companies outside Brazil imposed by Resolution 224 has got to be seen as a positive step.

Whether it will be enough to appease those in the market who feel the government has gone too far in its attempts to keep large reinsurance risks in Brazil remains to be seen. Further challenges seem likely. ■

WEB RESOURCES

WEB RESOURCES

Brazil's insurance laws

The CNSP – www.fazenda.gov.br/portugues/orgaos/cnsp/cnsp.asp

CNSP Resolution 168 – www.susep.gov.br/bibliotecaweb/docOriginal.aspx?tipo=2&codigo=23413

CNSP Resolution 224 – www.susep.gov.br/bibliotecaweb/docOriginal.aspx?tipo=1&codigo=27424

CNSP Resolution 225 – www.susep.gov.br/bibliotecaweb/docOriginal.aspx?tipo=1&codigo=27425

CNSP Resolution 232 – www.susep.gov.br/bibliotecaweb/docOriginal.aspx?tipo=1&codigo=27854

New provisions on reinsurance

THE ISSUES: How will the latest regulatory rulings aimed at developing the Chinese insurance and reinsurance market impact overseas reinsurers? How will the area of environmental liability be affected by tort reform?

THE CHINESE INSURANCE supervisor, the China Insurance Regulatory Commission (CIRC) has changed and strengthened some of the existing rules concerning reinsurance and indicated a move towards opening up the insurance sector in China.

A number of amendments have been introduced as part of CIRC's Provisions on the Administration of Reinsurance Business 2010 (the 2010 Provisions), which became effective on July 1, 2010. These include:

Offshore reinsurance restrictions abolished: Previously, insurers were required to offer at least 50% of a risk to at least two domestic reinsurers in China before ceding such risks to overseas reinsurers.

The 2010 Provisions abolished this requirement allowing much greater scope for non-admitted reinsurers to participate in China's fast-growing reinsurance market.

Clarification of the 80% reinsurance risk limit: Previously, direct insurers could not cede over 80% of the original insured sum or overall limit of liability to a single reinsurer, except in respect of aerospace, nuclear, oil or credit insurance.

The 2010 Provisions limit this restriction to proportional reinsurance only. While theoretically this could enable reinsurers to enter into "fronting" type arrangements, the restriction on an insurer entering into a facultative reinsurance arrangement for more

Shanghai is the centre of China's fast-developing insurance sector

than 20% of the sum insured or the limit of liability with an affiliated company, is retained.

Uniformity in reserving in personal lines: Under the 2010 Provisions, to prevent the insurer and reinsurer setting different reserves for the same risk they must adopt consistent methods and assumptions when assessing and setting reserves.

New categories of reinsurance: In 2005, the CIRC issued Provisions on the Administrative Regulations on Reinsurance Business, which recognised two methods of reinsurance, treaty and facultative. However, the 2010 Provisions identify three additional categories:

- Retrocession
- Proportional reinsurance
- Non-proportional reinsurance

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THE NEW TORT LAW

THE NEW TORT LAW

Changes may significantly impact the insurance industry, particularly in the area of environmental liability...

ON JULY 1, 2010, **the PRC Tort Liability Law** (the New Tort Law) became effective, largely codifying existing laws (including the **General Principles of the Civil Law of the PRC, the PRC Law on Protection of Consumer Rights and Interests, the PRC Product Quality Law, and the PRC Environmental Law**). The main changes are summarised below:

Liability for environmental pollution: Under the old regime, violation of national regulations on environmental protection was a pre-requisite for tortious liability. Under the New Tort Law, companies which comply with environmental rules and regulations may still face liability; Article 65 provides that if injury is caused by environmental pollution, the responsible party shall be liable, regardless of fault. Furthermore, the burden of proof is on the defendant who must show that the injury was not caused by its act in order to avert liability. These changes indicate that China is determined to make polluting parties responsible for their actions, which may prompt enterprises to consider increasing their insurance limits to reflect their potentially increased exposure under the New Tort Law.

Product liability: Due to various product liability scandals, particularly the melamine tainted milk incident in 2008, the New Tort Law significantly increases the legal consequences in respect of defective products by allowing the manufacturer or seller to be sued for damage caused by defective products.

A manufacturer will still be liable for a product defect even if the product has not been publicly available or the defects could not have been discovered with the techniques available at that time (which constituted a defence under the previous product liability law in China).

Where a manufacturer or seller is aware of a defect, they are now required to warn the public or initiate a public recall to protect consumers. Liability will be incurred even if the defect is caused by a third party, such as a transport or a warehouse provider, albeit that they may be able to recover any loss suffered from that third party.

Introduction of punitive damages: Article 47 of the New Tort Law introduces punitive damages under the product liability provisions available, provided that a manufacturer or vendor continues to produce or sell a product which it knows to contain a defect, resulting in death or serious harm to health. No methodology for calculating punitive damages is set out so it is uncertain how this will work in practice.

The recognition of additional types of reinsurance business highlights the fact that China's reinsurance market has developed considerably in the last five years, is expanding and growing more sophisticated.

The 2010 Provisions also: enhance the CIRC's supervisory role over the reinsurance industry by increasing the obligation on insurers and reinsurers to make regular filings and disclosures; encourage the development of catastrophe reinsurance in China; and increase the reporting requirements for foreign-invested insurance companies.

EASED RESTRICTIONS ON INVESTMENTS

On July 30, 2010 the CIRC issued Interim Measures for the Administration of Utilisation of Insurance Funds, the first comprehensive law regulating an insurance company's investments. An insurance company is now permitted to invest:

- up to 10% of its previous quarter's gross assets in real estate and infrastructure projects. However, it is still prohibited from engaging in real estate development
- up to 20% of its previous quarter's gross assets in public shares and equity funds
- up to 5% in unlisted enterprises
- up to 20% in unsecured enterprise (corporate) bonds and non-financial corporate debt financing instruments; and
- in Growth Enterprise Market and B shares (shares traded and registered in foreign currencies) although this is subject to some rules being promulgated by the CIRC.

Investment in venture capital is not allowed. Despite ongoing CIRC discussion in relation to investment in companies listed on the Hong Kong Stock Exchange no concrete proposal has yet been made.

LLOYD'S CHINA

LLOYD'S CHINA

LLOYD'S ESTABLISHED a wholly-owned subsidiary, Lloyd's Insurance Company (China) Ltd (Lloyd's China) in April 2007 to be able to write non-life reinsurance business in China.

There are currently six syndicates (namely Ace, Catlin, C.V. Starr, Navigators, Sportscover, and Travelers) physically operating within Lloyd's China and 11 participating from London. Syndicates participate in Lloyd's China by means of retrocession agreements which allow a 100% risk transfer. Retrocession to syndicates in London is effected through treaties between Lloyd's China and those syndicates. Lloyd's China allows supporting syndicates in the London market to access local currency business in China.

Last year, Lloyd's China obtained a license to directly write property insurance business in Shanghai and other provinces where it has a branch. This should significantly increase Lloyd's China's participation in China's growing direct insurance market.

NEW EQUITY RULES

On June 10, 2010, the CIRC issued Administrative Measures on Equities in Insurance Companies (the Equity Rules). The major provisions are:

Laws applicable to insurance companies with foreign ownership: The Equity Rules clarify the regulations applicable to foreign-invested insurance companies, providing that an insurance company with over 25% foreign ownership will be regulated as a foreign-invested company (subject to restrictions on its business

scope, additional financial qualifications and other requirements). For insurance companies with less than 25% foreign ownership, regulations for domestic insurance companies will apply.

Investments in more than one insurance company: Before 2010, investors were prohibited from investing in more than one domestic insurance company involved in the same type of insurance business.

The Equity Rules remove this restriction so foreign investors are permitted to make such investments provided that the companies involved are not in a competitive relationship or do not face a conflict of interest.

Possible exemption of the 20% shareholding restriction: The Equity Rules confirmed that foreign financial institutions, subject to certain conditions, are allowed to have an ownership interest in Chinese domestic insurance companies and relaxed the restriction that a single shareholder must not own more than 20% of a domestic insurance company's total registered capital; now, on a case-by-case basis, the CIRC may exempt a major shareholder from this restriction.

In order to qualify as a "major shareholder", an investor must: have more than a 15% shareholding, or have a direct or indirect controlling right over an insurance company; have been profitable for the last three consecutive years; and have a net asset value of at least RMB200m (US$30.5m).

The qualification requirements for a foreign investor in an insurance company remain the same; the investor must: have been profitable and have maintained a grade A credit rating for the last three consecutive years; and have no less than US$2bn of assets as of the end of the preceding year.

TOUGHER RISK MANAGEMENT REQUIREMENTS

In June, 2010, the CIRC issued Draft Guidelines on Implementation of Enterprise Risk Management for Life and Health Insurance Companies (the Draft Guidelines), and solicited public opinion on the proposed risk management guidelines.

The Draft Guidelines distinguish eight types of risk: market, credit, insurance, business, operational, strategic, reputation and liquidity. The CIRC recommends that life companies implement appropriate systems to deal with different types of risk. Insurers are advised to establish an independent risk management committee to report to the board of directors and appoint a senior member of staff to assume the role of chief risk management officer. ■

WEB RESOURCES

General
www.circ.gov.cn

Provisions on reinsurance
www.circ.gov.cn/web/site0/tab68/i133947.htm

www.asianlii.org/cn/legis/cen/laws/tpgrb494/

Eased restrictions on investment
www.circ.gov.cn/web/site0/tab68/i137280.htm

New equity rules on insurance companies
www.circ.gov.cn/tabid/106/InfoID/130346/frtid/3871/Default.aspx

New tort law
www.gov.cn/jrzg/2009-12/26/content_1497422.htm

The ACP is a newly-created independent French regulator, operating under the auspices of the French Central Bank

A new regulator

THE ISSUES: How will a major review of the French regulatory framework in response to the financial crisis, the Madoff fraud and inadequacies in the distribution of the retail investment products sector, impact insurers?

FOLLOWING THE GLOBAL financial crisis insurance companies, like banks, have undergone a depreciation of their assets which has affected their profit margins. But unlike banks, insurance companies have not faced cash-flow constraints.

The major impact of the crisis largely didn't affect French life insurance and savings products. Indeed, by the end of 2009, the amounts invested in life insurance placements exceeded €135bn (US$193m) i.e. an increase of 13% over the year. Thus, despite the financial crisis, life insurance in France has been a rather profitable activity.

THE INSURANCE EVOLUTION

In 2010, the insurance industry continued to display growth against the backdrop of a gloomy economical and financial environment.

Overall premiums reached a total of €207.2bn, but at a slower rate of growth compared with 2009 (+4% in 2010, as opposed to 9% in 2009).

However, according to Bernard Spitz, president of the FFSA (Fédération Française des Sociétés d'Assurances), the scars left by the crisis can still be seen in 2011.

He has strongly emphasised the need for the French economy to develop long-term private savings which can then be utilised to finance commercial and industrial activities and also to be used as financial leverage to support economic entities.

Insurance business therefore has a major role to play and it is in this context that the the French Prudential Control Authority (ACP) has been established.

The ACP is a newly-created independent French regulator, created by a decree dated January 21, 2010 and officially set up on March 9, operating under the auspices of the French Central Bank (Banque de France).

> "The ACP will certainly contribute to clarifying the French landscape on insurance and bank supervision"

The main aims of the ACP are to supervise the banking and insurance industries for the protection of customers and to maintain the stability of the French financial system in the insurance industry.

FORMATION OF THE ACP

The ACP merges four French regulatory authorities which have previously supervised the French banking, insurance and financial services industries.

These are the Commission Bancaire (CB) and the Autorité de Contrôle des Assurances et des Mutuelles (ACAM), responsible respectively for the ongoing supervision of the financial services and insurance industries; and the Comité des Etablissements de Crédit et des Entreprises d'Investissement (CECEI) and the Comité des Enterprises d'Assurance (CEA), responsible respectively for granting authorisations, licences and derogations to firms operating in such industries.

From now on, the delivery of licences and the ongoing prudential supervision of the entities and persons in both the financial services industry and the insurance industry are entrusted to the ACP.

DISCIPLINARY POWERS

DISCIPLINARY POWERS

The ACP has various powers to impose safeguarding measures and/or sanctions or penalties. These are set out below and may only be imposed by the Sanctions Committee, although the initiation of sanction proceedings lies with the board:

WARNINGS: if the insured's interests are compromised, the ACP has the authority to issue a warning with respect to potential criminal actions but only after the company's management has had a chance to present its case.

NOTICES: the ACP can issue notices requiring an insurance company to take all measures necessary to comply, within a certain specified timeframe, with its legal obligations.

REVIVAL PROGRAMMES: the ACP can require an insurance company to submit for its approval a "revival programme" which should put forward all necessary measures to be taken in order to restore or strengthen its financial situation.

CONSERVATORY MEASURES: if a company is about to be insolvent or the interests of its insured are compromised, or likely to be compromised, the ACP may require conservatory measures to be taken, for example: placing the company under special supervision, restricting or temporarily forbidding the free disposal of all or part of the company's assets or suspending one or more managers of the controlled entity.

Fines of up to €100m can be imposed and the ACP has the power to issue injunctions and to suspend a company's activities.

The ACP will certainly contribute to clarifying the French landscape on insurance and bank supervision. To a certain extent, common standards shall be applied to bank and insurance although the banking sector shall prevail in the scope of activities of the ACP. It is however too early to say whether new guidelines shall emerge from ACP supervision of the insurance market.

The ACP also aims to protect consumers through monitoring compliance by banks and insurance companies with legal and regulatory provisions and relevant best practice guidelines. In this respect it has the power to make recommendations to insurance companies (and banks).

Alongside the board of the ACP, a committee has been set up – the Sanctions Committee (*see Disciplinary Powers box*) – and therefore the ACP is effectively comprised of two different bodies. Two dedicated sub-committees have also been established, one for insurance, the other for the banking sector. These sub-committees of the main board are charged with supervising each sector.

The ACP will co-ordinate its actions with France's existing independent supervisory authority for financial markets, the Autorité des Marches Financiers (AMF).

This is with a view to harmonising the supervision of the distribution and marketing of all financial products, including life insurance, pension products and mutual funds. The co-ordination point between the ACP and the AMF is called the *Pole Commun* (joint unit) and this acts as a watchdog for such joint supervision and for compliance by the regulated entities with their professional obligations towards consumers. Consumers can contact the joint unit directly in respect of queries and claims and follow-up sanctions are dealt with by the appropriate authority (insurance and credit claims falling within the remit of the ACP and financial products within that of the AMF and the Brigade Financière).

POWERS OF THE ACP

Unlike the AMF, the ACP has no regulatory power. Dealing specifically with insurance, its different powers are detailed below:

- **Administration of insurance companies:** The ACP is responsible for granting licenses to insurance and reinsurance companies.

The ACP monitors EEA firms seeking to passport their activities in France under the so-called European passport (free provision of services or freedom of establishment). Before delivering a licence to a branch of an insurance company licensed in another member state, the relevant authorities of such member states must be consulted.

The ACP also supervises changes in shareholding structure and changes in management for insurers and reinsurers.

- **Supervision to ensure compliance with law and regulatory provisions:** The ACP is also responsible for ensuring compliance of European companies operating in France with the legal provisions applicable to them, in order to safeguard the interests of policyholders, insureds and beneficiaries.

The ACP must operate within the framework of the "home country control principle". Accordingly, the ACP has authority to control compliance with national rules of public policy in relation to consumer protection, and advertising etc.

However, it does not have jurisdiction in respect of so-called "structural company rules" and therefore compliance in respect of, for example, the company's financial situation; solvency; and capacity to comply at any moment with its engagements vis-à-vis its insured, remains with the authorities of the relevant home country member state. ■

WEB RESOURCES

Impact after the global financial crisis
www.ffsa.fr

- Assurance: les résultats de l'année 2010 » 27/01/2011
- L'assurance face à la crise économique » 26/01/2010
- Bernard Spitz : L'assurance vie occupe « une place primordiale dans le financement de l'économie française » 27/01/2011
- Crise financière, le point de vue de Bernard Spitz, président de la FFSA ». 23/02/2009.

The Reichstag: Germany's insurance contract laws have been reformed

Interpreting the new Act on insurance contracts

THE ISSUES: How have German courts dealt with the country's new laws concerning insurance contracts since they were introduced?

The reformed Act on insurance contracts came into force in Germany in 2008 and it revised the old laws quite dramatically. But how have the courts interpreted the new rules since then?

According to **Section. 19 (1) of the German Insurance Contract Act (VVG)**, before making a contractual acceptance, the policyholder shall disclose to the insurer only those risk factors known to him/her which are relevant to the insurer's decision to conclude the contract with the agreed content and which the insurer has requested in writing.

The legislator has explicitly excluded a spontaneous duty of disclosure. The insurer must ask specific questions. Section 19 belongs to the so-called "semi-binding rules" of the VVG, which may not be altered to the disadvantage of the policyholder.

Parties to large insurance contracts and open policies within the meaning of **Section 210 of the VVG** can waive the binding and semi-binding rules.

It is normal procedure in Germany for brokers to ask their clients questions in relation to risk

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CASE FOCUS: BEFORE THE COURT OF APPEAL

IN A RECENT DECISION the OLG Hamm (Court of Appeal) had to rule on the cover under a property and business interruption insurance contract.

The policyholder, a manufacturer of bathroom fittings, insured several buildings with a syndicate of insurers through a large broker.

The defendant was one of the insurers but not the leading one. A fire in an adjoining factory spread to the insured buildings and caused severe damage. All of the syndicate insurers, save for the defendant, settled the claim. The defendant declared withdrawal from, and rescission of, the insurance contract citing reasons of non-disclosure and fraud.

The argument for withdrawal was based on an alleged non-disclosure of pre-contractual questions. The broker had provided the defendant with a report in which the question about adjoining factories was answered with a "no" - in fact this answer was incorrect. The report was in fact drafted and answered by the broker.

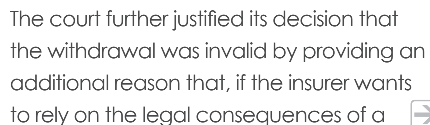
OLG Hamm confirmed the decision of the court of first instance that the withdrawal was void. Although it held that the question in the report about adjoining factories was relevant to the insurer's decision to conclude the contract with the plaintiff, it argued that the question was not asked by the defendant insurer, but by the broker.

This decision means that it would be possible for an insurer to use a questionnaire which was created by someone else. It would also be possible that a representative of the potential policyholder answers the pre-contractual questions or that a representative of the insurer asks the questions.

In the circumstances of the case, however, the court declined to attribute the questions in the report to the insurer: The broker had negotiated the contract for and on behalf of the potential policyholder. It was beyond any doubt that the broker was on the side of the policyholder. The plaintiff itself was not involved in negotiating the contract at any time.

The court argued that, if the questions of the broker could be attributed to the insurer, this would lead to a reintroduction of the spontaneous duty of disclosure. It stated that this could be seen differently, if the insurer declares in writing at the same time that the questionnaire has to be deemed as its own. The court did not rule whether it would be sufficient for the insurer to declare this afterwards.

DECISION JUSTIFIED



The court further justified its decision that the withdrawal was invalid by providing an additional reason that, if the insurer wants to rely on the legal consequences of a

non-disclosure, it has to give the potential policyholder a warning.

Section. 19 (4) of the VVG stipulates that only if the insurer has, in separate written correspondence, notified the policyholder of the consequences of any breach of the duty of disclosure, shall he/she be entitled to withdraw from the contract .

OLG Hamm stated that such notification is also required in cases of industrial insurance and large risks contracts. Although the parties to such insurance contracts may waive Section19 (4) of the VVG, this has to be clearly agreed in the contract. Differing customs and practice in industrial insurance cannot change this.

MINIMUM RISK MANAGEMENT REQUIREMENTS

The German supervisory authority's (BaFin) so-called MaRisk (VA) is keeping the German insurance industry busy...

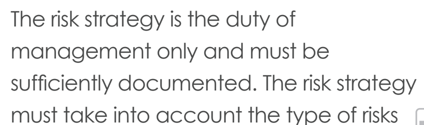
BAFIN'S NEW MaRisk (VA) is binding for German insurance companies, whether they are direct insurance carriers, reinsurers, pension funds and holdings, as well as covering branches in EU-member states and EEA-countries.

MaRisk is an administrative regulation which is supposed to help to interpret **Section 64a of the German Insurance Supervision Act**. Section 64a came into force on January 1, 2009 and contains rules regarding the business organisation of insurance companies.

It defines risk management as a central part of sufficient business organisation of insurance companies but uses a lot of vague and undefined legal terminology. MaRisk's purpose is to clarify these legal terms.

The requirements of MaRisk are very similar to Solvency II. Insurance companies are obliged to control and adapt their risk management procedures according to the standards set out in MaRisk.

Although the MaRisk regulation does not require exact obedience of administrative rules, it does require consistent risk management, in order to convince BaFin of its effectiveness. Such consistent risk management is based on four pillars – the company must have implemented a sufficiant risk strategy; be risk-focused; have put in place an appropriate control system; and have an auditing department within its structure.



RISK FACTORS

The risk strategy is the duty of management only and must be sufficiently documented. The risk strategy must take into account the type of risks

faced, the risk tolerance, the origin of the risk, the time frame and the capacity for responding to risks and must outline the risks which result from the business strategy.

The second pillar of consistent risk management is a risk-focused organisation.

For this purpose, the principle of separation of functions is applicable. The units or persons which are responsible for the developing of risk positions, are not allowed to participate in the control-system or the internal audit procedure.

The third pillar is a sufficient internal control system, setting out the processes for identifying, assessing and controling risks and the procedure for reporting to the board of directors.

The auditing department within the company is the fourth pillar of consistent risk management.

The auditing department must be set up so that it is able to fulfil its duties objectively and independently, and it must comprise sufficiently qualified employees and have a right to require information from, and to inspect the relevant departments.

Furthermore, only the management board has the right to give directions to the internal auditing department.

MaRisk was supposed to resolve the questions created by the use of vague legal terms in the German Insurance Supervision Act. In fact it has it produced a range of new legal issues.

which they think are important and to forward the answers to the insurers along with their request for placement of the risk. Often therefore, the insurer does not ask its own questions.

In future, the way many industrial insurance contracts are drawn-up will have to be changed.

Many questionnaires, especially those of brokers, do not contain the instructions required by **Section. 19 (4) of the VVG** (*see Case Focus box, page 27*).

If an insurer wants to rely on the legal consequences of a non-disclosure, it must ensure that the making of the contract complies with the requirements of Section. 19 of the VVG and should not rely on mere broker information. ■

WEB RESOURCES

Gender pricing
www.focus.de/finanzen/news/eu-gleiche-versicherungstarife-fuer-mann-und-frau_aid_604419.html

Solvency II
www.focus.de/finanzen.sueddeutsche.de/aktien/news_news?secu=292&dpa_news_id=7251920&news_id=

www.focus.de/finanzen.sueddeutsche.de/aktien/news_news?secu=313%20292&dpa_news_id=7823575&news_id=

An Independent Insurance Authority

THE ISSUES: What will be the impact of the Hong Kong insurance regulator's potential split from the island's government? Can D&O underwriters expect another hard-line approach from the new head of the Securities and Future Commission?

HONG KONG'S INSURANCE INDUSTRY is currently overseen by the Office of the Commissioner of Insurance (OCI), a regulatory body established to administer the Insurance Companies Ordinance (ICO).

The OCI is headed by the Commissioner of Insurance who is appointed by the Insurance Authority (IA) and whose principal functions are to regulate and supervise the insurance industry. The OCI is not independent of the government. However, this system may soon change.

On July 12, 2010, Hong Kong's Financial Services and the Treasury Bureau (FSTB) issued a consultation paper on the proposed Independent Insurance Authority (IIA), entitled Proposed Establishment of an Independent Insurance Authority.

The consultation period ended in October of last year and a bill is expected to come before the Legislative Council during 2011.

The proposal for an IIA was made against the backdrop of the global financial crisis and amid concerns that the current regulatory regime was not in line with the international practice of financial regulators being financially and operationally independent from government.

It is anticipated that establishing the IIA will not only achieve this independence but will also maintain stability in the insurance industry, increase the flexibility with which changes in the international financial markets and developments in international regulatory requirements can be met, and offer increased protection to policyholders.

THE PROPOSALS

Regulation of insurers: It has been proposed that the IIA be given additional powers in relation to the regulation of insurers to address any future situations where policyholders' interests may be compromised or financial stability undermined. The proposals give the IIA additional investigative and disciplinary powers similar to those of overseas' regulators.

Insurers could therefore be held more accountable in terms of their compliance with regulatory requirements and, consequently, they may need to take additional internal measures to ensure their ongoing compliance. Some insurers have complained that increased regulation will result in greater cost to the industry, however, that view is not shared by all. Many welcome the proposed changes and see the associated costs as necessary to improve the image of the industry and make it more robust.

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SFC CHIEF RESIGNS – WHAT ARE THE IMPLICATIONS FOR D&O?

SFC CHIEF RESIGNS – WHAT ARE THE IMPLICATIONS FOR D&O?

Over the last two years, one of the biggest concerns for financial lines underwriters, especially of D&O insurance, has been the increased activity of the Securities and Futures Commission (SFC) ...

THE MONTH OF FEBRUARY saw Martin Wheatley appointed as the new managing director of the consumer and business unit of the UK regulator, the Financial Services Authority (FSA). He was also confirmed as the chief executive designate of the Consumer Protection and Markets Authority (CPMA), one of the two successor regulatory bodies that will be formed from the future division of the FSA.

However, in Hong Kong, and largely under Wheatley's watch, the SFC has adopted a visibly hard-line approach to enforcing the provisions of the Securities and Futures Ordinance (SFO), particularly in relation to the investigation and enforcement of cases involving market misconduct, and in respect of regulating the IPO market.

MARKET MISCONDUCT

The SFC has become very active in pursuing directors and officers (D&O) alleged to have committed market misconduct.

It has extensive powers under the SFO to obtain relevant documents and conduct interviews. Market misconduct is defined in the SFO as insider dealing, false trading, price-rigging, disclosure of information on prohibited transactions, disclosure of false or misleading information, or stock market manipulation.

The SFC pursued most cases of market misconduct through summary criminal proceedings before a magistrate, or in more serious cases through prosecution by the Department of Justice. To a lesser extent, the SFC pursued cases through civil proceedings before the Market Misconduct Tribunal (MMT) established under the SFO.

Penalties under both the criminal and civil regimes can be severe. Criminal penalties can include fines of up to HK$10m (US$1.28m) and prison terms of up to 10 years, while the MMT has the power to order the disgorgement of profits gained or losses avoided and can suspend individuals from holding office as director, liquidator, receiver or manager of a corporation, or prevent individuals from operating in the financial markets in Hong Kong for up to five years in each case.

Since December 1, 2009, the SFC has successfully obtained disqualification orders against eight directors of listed companies for market misconduct.

This included obtaining a court order on March 18, 2010 against three directors →

of Rontex International Holdings Limited disqualifying them for periods of between four to five years each.

The directors' misconduct related to their involvement with investments Rontex or its subsidiaries entered into between 2002 and 2005 which resulted in losses of around HK$19m. The SFC also obtained an order requiring Rontex to commence legal proceedings against the three directors in an attempt to recover the losses suffered.

IPOs

The SFC has also been particularly active in its regulation of IPOs. Most recently it commenced proceedings against the chief executive of China Forestry Holdings Co. Limited on February 2, 2011 - an injunction freezing his assets has been obtained. China Forestry was listed on the Hong Kong Stock Exchange on December 3, 2009. The SFC's proceedings arise from an announcement by the company's auditors that possible accounting irregularities for the financial year ended December 31, 2010 have been identified.

Another recent example of the SFC's vigilance is the commencement of court proceedings against Hontex International Holdings Company Limited in April 2010 and the obtaining of an injunction freezing Hontex's IPO proceeds.

The SFC's allegations include that Hontex's IPO prospectus issued in December 2009 was misleading as it overstated Hontex's financial position.

IMPLICATIONS FOR THE INDUSTRY

The SFC's increased activity and the resultant increase in exposure for directors and officers comes at an almost certain cost to underwriters, since most D&O policies cover investigation and defence costs.

It remains to be seen whether increased regulation will be introduced in the future as a response to the growing number of SFC prosecutions.

More immediately, the extent to which directors and officers will continue to face the risk of prosecution following Wheatley's departure is uncertain. To some degree, it will depend on whether Wheatley's successor adopts a similarly tough stance on market misconduct.

Regulation of insurance intermediaries: A self-regulatory regime currently exists for insurance intermediaries via three organisations: the Insurance Agents Registration Board; the Hong Kong Confederation of Insurance Brokers; and the Professional Insurance Brokers Association (**the SROs**).

Critics complain that there is inconsistency in how these SROs operate, that they have limited investigatory and sanctioning powers, and that the existing regime is out of step with international practice.

The proposals seek to address these concerns by moving away from a self-regulatory model

and creating a licensing regime which will give the IIA direct supervision over the SROs. Many consider this a positive move which will increase confidence in Hong Kong's regulatory regime.

Regulation of insurance products sold in banks: Currently, around 30% of insurance products sold in Hong Kong are sold through banks.

Regulation of this area is the responsibility of the Hong Kong Monetary Authority (HKMA), which lacks the power to discipline individual bank employees in their role as insurance intermediaries.

It is therefore proposed that the HKMA be given powers similar to the IIA, including the power to conduct inspections, carry out investigations and impose disciplinary sanctions.

Checks and balances: The existing regime provides limited scope for appealing decisions of the IA.

Appeal can only be made to the financial secretary under the provisions of the ICO. Upon the creation of the IIA it has been proposed that: a governing board be appointed by the government to provide leadership and direction, and to guide the IIA in the development of a corporate strategy; the governing board being assisted by a number of committees designated to oversee specific areas of the IIA's work and make recommendations to the board; and finally a statutory appeals tribunal for appeals against the decisions of the IIA and HKMA and an independent process review panel to review the internal operating procedures of the IIA and HKMA be established.

These proposed checks and balances should enhance the credibility of the IIA and the role it will play within the Hong Kong insurance industry.

Funding of the IIA: It is estimated that the annual operating cost of the IIA would initially be around HK$240m (US$30.8m). Since the IIA is required to be financially independent, it is proposed that a fee structure be implemented.

In order to reduce the initial impact on the insurance industry and policyholders it is proposed that, for five years following the establishment of the IIA, licence fees for insurance intermediaries be waived and an incremental approach adopted in achieving the target levels of variable licence fees on insurers and levies on insurance policies. Further, the proposal calls for the government to contribute HK$500m up front to cover the IIA's initial expenses.

CONCLUSION

Should the IIA be created it will bring Hong Kong's insurance industry in line with the approach taken to regulation in many other jurisdictions. Provided the IIA is prepared to use its new powers the industry should be better placed to adapt to changes in international financial markets and regulatory requirements, while maintaining financial stability and protecting the interests of policyholders. ■

WEB RESOURCES

Hong Kong regulation

www.gov.hk/en/residents/

www.oci.gov.hk/about/index.html

www.hksfc.org.hk/sfc/html/EN/

Class action settlements and the duty to provide information

THE ISSUES: Why is the Netherlands set to become an important venue in the collective redress of international mass damages claims? Why are insurers attracting more attention in the area of duty of care?

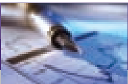
THE DUTCH COLLECTIVE ACTION (**Financial Settlement) Act (WCAM**) came into force in 2005 and is unique in Europe.

In short, the WCAM provides that parties to a settlement agreement may jointly request the Amsterdam Court of Appeal to declare the settlement binding.

The settlement has to be concluded between a representative association and the allegedly liable parties. If all procedural requirements and legal safeguards are met, the court will grant the request.

"The advantage of settlement via the WCAM is that it puts an end to lengthy legal actions and provides certainty on payment obligations"

As a result, all "class members" – the persons covered by the settlement terms – will be bound by the settlement. They are entitled to damages in accordance with the agreement but to no more than that.



CASE FOCUS: THE AHOLD SETTLEMENT

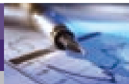
CASE FOCUS: THE AHOLD SETTLEMENT

WITH REGARD to recognition of a US class action settlement in The Netherlands, the District Court of Amsterdam gave a landmark judgment on June 23, 2010.

In the US, the so-called Ahold settlement was declared binding on Ahold shareholders worldwide. Nevertheless, a group of Ahold shareholders had instituted a claim in the Netherlands.

The Amsterdam Court decided that the US class action settlement in the Ahold case meets the Dutch standards of proper judicial procedure and can be recognised and enforced in the Netherlands.

This implies that, in principle, Dutch class members who do not opt-out within the relevant timeframe are bound by the US judgment and can claim no further compensation than that provided for in the US Ahold settlement. Appeal against this decision is still open.



CASE FOCUS: AFTER MORRISON v. NAB

CASE FOCUS: AFTER MORRISON v. NAB

IN JUNE 2010, the US Supreme Court in *Morrison v. NAB* held that foreign investors who purchase shares on foreign exchanges cannot sue foreign companies in the US. Subsequently, the question was raised as to how and where these so-called "f-cubed cases" could be filed in the future.

In its provisional ruling of November 12, 2010 in the *Converium* case, the Amsterdam Court of Appeal has answered this question. In principle, the Dutch WCAM-procedure can be followed. In short, this case relates to a US class action by securities holders throughout the world against Converium.

This resulted in a US class action settlement, but - pursuant to the Morrison-ruling - only with regard to US residents and/or investors on the NY Stock Exchange.

With regard to all other investors a complementary settlement was reached. The representative parties to this complementary settlement petitioned the Amsterdam Court of Appeal to declare the settlement binding.

The view of the Amsterdam Court of Appeal is that the Dutch Converium-settlement aims to complement the US settlement and, within the EU, only the Netherlands offers the possibility of having a settlement agreement declared binding on a class.

The court then discussed the different sets of jurisdiction rules applicable to the different groups of shareholders (**Regulation 44/2001** regarding EU residents, **the Lugano Convention (II)** regarding residents of Norway, Switzerland and Iceland and **Dutch Civil Procedural Law** regarding all other foreigners).

After analysing and applying these rules the court concluded that it has jurisdiction. Amongst other things the court considers that it has jurisdiction regarding Dutch security holders and the other claims are closely connected to them. Furthermore, payment of the settlement agreement will be made in The Netherlands.

The ruling is provisional however and the court will issue a final decision once all interested parties have had the opportunity to be heard.

However, class members are given a chance to "opt-out" during a certain specified time period. In that case, they will not receive settlement compensation and can still bring their original claim to court.

The advantage of settlement via the WCAM is that it puts an end to lengthy legal actions and provides certainty on payment obligations. Defendants (and their insurers) are able to solve disputes with potentially many possible claimants by having the settlement agreement declared binding on all members of the class.

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DUTY TO PROVIDE INFORMATION

DUTY TO PROVIDE INFORMATION

In the Netherlands, insurers' duty of care towards their clients – especially the duty to provide information – is still a hot topic...

WHILE LEGISLATION and case law were initially focused on banks and investment products, in recent years insurers and insurance intermediaries are attracting more and more attention.

The allegedly excessive costs in unit-linked life insurance policies - the still ongoing *woekerpolissen* affair – play a centre-role.

The need for transparency has led to increased supervision and regulation of insurers' conduct of business and case law has focused on the civil liability of insurers and brokers towards their clients. In 2007 the **Financial Supervision Act** – *Wet op het financieel toezicht* (Wft) came into force.

Pursuant to this Act, financial undertakings – including insurers and brokers – have *inter alia* to supply information to the client which is reasonably relevant for an adequate assessment of that service or product (**Section. 4:20 Wft**).

In **Section. 4:23 Wft** the "know-your-client" obligation has been formalised. The Dutch Association of Insurers (*Verbond van verzekeraars*) has also issued information codes of conduct applicable to its members.

Such supervisory regulation aims to protect the public. In civil liability the specific circumstances of the particular case play an important role. Sometimes, this results in the assumption of duties of care which go further than the specific obligations stipulated in the Wft.

The ruling of the Court of Appeal in Leeuwarden in May 2010 (**PJ 2010/131**) is interesting. The court first established that the old supervisory rules no longer apply.

However, the court considered that these rules (to provide information, to know-your-customer and to warn them if necessary), form the basis for the civil law duties of care of the insurer.

Another case ruled on by the District Court of Alkmaar on February 3, 2010 (**LJN: BL2919**) involved non-provision of information and resulted in a breach of a specific duty of care.

The court found that the (now bankrupt) DSB bank, acting as an insurance intermediary, was liable for not informing the plaintiffs of the disadvantageous costs structure involved and for not presenting them with alternatives.

An insured who has been allegedly misinformed about relevant aspects of an insurance contract can – if he has also suffered a breach of a duty of care - found a claim on mistake (*dwaling*) or fraud (*bedrog*).

For example, the Arnhem Court of Appeal, in February 2006 (**NJF 2006, 282**) ruled that an agent of the insurer had breached a duty to warn the insured about an exclusion from coverage because the insured used its audio-equipment in an unprofessional manner. Because of this breach, the insurer had to indemnify the insured.

This manner of settlement is similar to that in US class actions, the difference being that, in the Netherlands, the parties must first conclude a settlement themselves.

Since 2005, five settlements have been declared binding in WCAM-procedures. The first case concerned damages for personal injury and the other cases involve financial loss. Recently, important judgements have been passed in respect of jurisdiction in worldwide class settlements, providing compensation to a large number of foreign class members, as well as international recognition of settlement orders (*see Case Focus, Page 35*).

"SHELL CASE"

In 2009, in the so-called "Shell case", WCAM-proceedings were applied to a worldwide settlement, binding both Dutch and foreign Shell shareholders belonging to the class (with the exclusion of the US shareholders who are class members in a complementary US settlement).

However, in that case one of the Shell companies involved in the settlement was Dutch, as were a number of the class members and the shares were partly bought on the Dutch exchange. A new feature of the Converium case is that not only are the large majority of the investors foreign, but they have also purchased shares in foreign on a foreign exchange market (in this case, Swiss on the Swiss market).

RECOGNITION

Whether all foreign courts will recognise Dutch WCAM-settlement judgments is still unclear. Due to **Regulation 44/2001** and **Lugano Convention II**, in principle the WCAM-judgment must be recognised in most European states. However, a recent research report ordered by the Dutch government points out that there is a "mismatch" between the WCAM and European rules on jurisdiction and recognition so further clarification and/or new legislation at the European level is required. ■

WEB RESOURCES

Solvency II:

www.verzekeraars.nl

«Position Paper Solvency II». 03/2011

www.dnb.nl

« Results of QIS5 on Solvency II for insurers». 14/03/2011

Gender Pricing after ECJ ruling

www.verzekeraars.nl

Compensation clauses and compulsory insurance

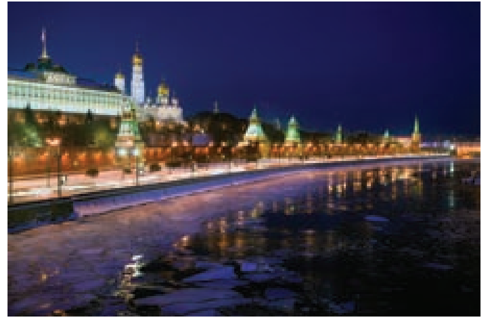
THE ISSUES: What are the latest developments surrounding insurance compensation? What is the likely impact of two new bills for Russia's transport insurance market?

INSURERS AND INSUREDS have been in dispute over clauses which relieve the insurer from the obligation to pay the insured compensation.

In a revolutionary case heard in 2009, the Federal Arbitrazh court of Moscow district ruled that provisions of an insurance contract setting out grounds to discharge insurers from liability to make payments that are not expressly provided by the law, are void.

The court's opinion made particular reference to the argument in respect of the insured's gross negligence, but the position was understood to apply more broadly – the effect being that generally insurers are prohibited from introducing new grounds to refuse payment into their policies or rules of insurance.

This position has been upheld by the courts. Insurers have, however, found a way around this constraint – the same grounds being now listed as exemptions from insurance cover rather than grounds to refuse payment. Despite significant debate about the extent to which such exemptions are allowed, the courts have yet to clearly pronounce on this issue, therefore allowing the insurers some space for manoeuvre.



Moscow: Significant regulatory reform is on the cards for Russia's insurers

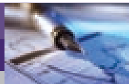
ONE TO WATCH

ONE TO WATCH

BY A RECENT decree the Russian President, Dmitry Medvedev has abolished the Federal Service for Insurance Supervision. Its functions are being passed to the Federal Financial Markets Service (FFMS) and the Ministry of Finance. The exact distribution of functions is still unclear and should be determined by the government. In any case, this step may lead to significant changes in the administrative regulation of insurance in Russia.

INSURED IMPACT

Under Russian law, the insured must make sure that a subrogated claim is feasible and



CASE FOCUS: IN ARBITRATION

CASE FOCUS: IN ARBITRATION

IN A RECENT ARBITRATION case involving non-disclosure issues, the insurer referred to non-disclosure of what he considered to be a significant fact, as a ground to refuse payment of insurance money.

It was found that neither the questionnaire nor the insurance contract contained any misleading information provided by the insured.

The insurer did not request additional information and agreed to provide cover. When refusing to pay the insured compensation, the insurer referred to an operational restriction which neither influenced the risk of damage to, or loss of, the insured property, nor was related to the insured event, nor could impact the insurer's decision to provide cover.

In this case, arbitrators ruled that, if a certain piece of information is not referred to in the insurance contract and/or in the written questionnaire, the burden of proof that such information is significant lies with the insurer. Finding further that the fact in question had no connection with the insured event, the arbitrators ruled that the insurance compensation was due to the insured.

The main argument of the insurer was that the insured did not communicate a fact, which although not requested by the insurer, had substantial significance to him. It was important that this "significant" fact had no connection to the incident in dispute, and due to no legal requirement to disclose, had not been evidenced by the insured.

not estopped or barred. If this is not the case, the insurer is entitled to refuse payment.

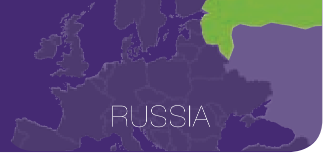
A recent development in court – and one unfavourable to insureds – shows that the courts apply this rule and deny payment even in such cases where the insured has duly filed a court claim against the party responsible for damages but, due to insufficient evidence or other causes, the claim was ultimately not satisfied by the court.

In addition, under Russian law the duty of disclosure is relevant at any stage of insurance relationships. When concluding the contract of insurance, the insured is obliged to disclose to the insurer any facts known to the insured which have a "substantial significance" for determining the extent of risk.

During the term of the insurance contract the insured, or the beneficiary, has the duty to inform the insurer immediately of any substantial changes in such facts.

"SUBSTANTIAL SIGNIFICANCE"

The concept of "substantial significance" may be interpreted in different ways depending on various factors, including, for example, the type of insurance and the object of insurance. Even the approach of a particular insurer (or judge) is important.



THE COMPULSORY INSURANCE CONUNDRUM

THE COMPULSORY INSURANCE CONUNDRUM

The Russian Parliament is currently considering two bills that may significantly change the transport insurance market...

THE FIRST BILL concerns compulsory insurance of carriers for passengers. The law, when enacted, will make such insurance compulsory for all Russian carriers irrespective of the type of transport.

The bill does not define the geographical scope of carriage and it is anticipated that it will apply to Russian carriers performing both domestic and international carriage of passengers. By virtue of a restriction contained in the law, only Russian-licensed insurers will be allowed to effect such compulsory insurance.

It should be understood that this restriction has applied for many years, and carriers who were nevertheless interested in insuring their risks on international markets, have generally been successful in finding solutions.

Still, the new law is expected to make a difference: it provides strict and detailed guidelines as to the documents required to obtain insurance payment and the time allowed for the insurer to consider the passenger's claim etc. Considering these mandatory guidelines, it will be the duty of the Russian insurer and not foreign re/co-insurers to be cautious about claims handling.

ENVIRONMENTAL MARINE IMPACT

The second bill in question, that of a law on compulsory insurance of owners and operators of sea-going and river vessels against environmental pollution, has caused a stir.

The law will apply to all vessels that operate in Russian inland waters, territorial seas and the exclusive economic zone, irrespective of the vessel's flag and the nationality of owner/operator.

As a general rule, Russian law prescribes that the insurance should be effected by a Russian-licensed insurer.

For those shipowners who prefer their own P&I clubs to Russian insurers a loophole may remain - the law provides an exemption where the liability is already covered by a foreign insurer, but only subject to strict compliance with all other provisions of the law.

This means, in particular, that the existing P&I cover should exactly match the new Russian law in terms of the description and scope of covered risks (which may be problematic since the law does not always correspond with the international conventions in this field, and the standards of international P&I clubs).

If it turns out that the existing P&I cover is not suitable, the shipowners will need additional cover to be able to enter Russian waters and/or call Russian ports. However, the minimal term of cover under the bill is one year or the navigation period. There seems to be no answer to a simple question: what if the foreign vessel calls at a Russian port only once?

The bill has been criticised for being inconsistent in some respects with the international conventions regulating liability for pollution at sea.

As an example, while the International Convention on Civil Liability for Oil Pollution Damage (CLC) provides for strict liability of the ship's registered owner, the Russian bill makes the insurance compulsory for all persons and entities who operate a vessel on a legal ground, for example, for bareboat-charterers, time-charterers and, potentially, operators, thus implying these entities' liability for pollution.

It should be noted that, despite the industry's concerns over the two bills, it is envisaged that both laws will be enacted in the near future.

The Civil Code of the Russian Federation contains a somewhat vague definition, explaining that, in any case, circumstances specifically referred to by the insurer in the standard form of insurance contract, policy, written questionnaire or similar document, are recognised as substantial. This does not mean that anything not mentioned in such documents is insignificant, but does at least provide some guidance. The test used in the Civil Code is that the insurer should not provide misleading information on the significant facts. Breach of this obligation may invoke the insurer's right to contest the validity of the insurance contract in court.

Certain specific acts provide for different rules. In particular, the Merchant Shipping Code obliges the insured to disclose any "significant information" but does not define or restrict this term in any way. The consequences of non-disclosure are also stricter than in the Civil Code: the insurer becomes entitled to avoid payment of the insurance compensation, without the need to specifically contest the insurance contract.

This strict regulation, however, is tempered by the courts, and even more so by the arbitrations *(see Case Focus, page 39)*. ■

"During the term of the insurance contract the insured, or the beneficiary, has the duty to inform the insurer immediately of any substantial changes in such facts"

WEB RESOURCES

New Russian regulatory regime
www.insur-info.ru/press/63984/
www.kommersant.ru/Doc/1619546
www.kommersant.ru/Doc/1596841

Tax exemptions and failing insurers

THE ISSUES: Fiscal incentive schemes aimed at assisting captive, specialty and marine and hull liability insurers operating in the Lion City are to be extended. How will the regulator's plans for distressed companies work?

IT IS A DECADE since the Singaporean regulator, the Monetary Authority of Singapore (MAS) removed the cap on the percentage of foreign ownership of local insurance companies and opened up entry into the Singapore market.

Over this period Singapore has developed into an increasingly important regional centre for insurance and reinsurance.

Singapore has not only established itself as a global insurance centre and the leading reinsurance hub in Asia, it is also the largest captive domicile in Asia.

In March 2011, Singapore had 149 registered insurers, including 62 direct insurers, 27 reinsurers and 60 captive insurers.

Singapore also has the largest Lloyds presence in Asia, with 20 Lloyd's syndicates underwriting various classes of business through 17 service companies operating on the Lloyd's Asia platform.

This is indicative of what is an increasingly mature market, with capacity expanding across most classes of business including many specialty lines.

However, success can create new challenges. High levels of competition and capacity have led to pressure on rates over various lines in recent years. More fundamentally, the factors responsible for the successful development of the Singapore insurance market, including regulatory and fiscal fine-tuning, and investment in research and development, require constant re-evaluation in order to maintain this success.

Singapore is now the largest captive domicile in Asia

Singapore continues to encourage and invest in the establishment of institutions in areas such as natural hazards and catastrophe risks, which now include the Institute for Catastrophe Risk Management (launched in 2010); the Earth Observatory of Singapore (launched in 2009) and the Centre for Hazards Research (which dates from 2007).

Industry initiatives focused on developing human capital include the Financial Industry

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DEALING WITH FAILING INSURERS

DEALING WITH FAILING INSURERS

A consultation paper from the Singaporean regulator, the MAS, outlines powers allowing it to assist in situations where insurers face, or are already in, liquidation...

BY INTERNATIONAL STANDARDS the Singapore insurance market is widely considered to be well-regulated, and places emphasis on risk-focused supervision.

The Singaporean regulator, the Monetary Authority of Singapore (MAS) implemented a risk-based capital framework in 2004, the essence of which is the requirement that insurers hold levels of capital determined by the risk profiles of their assets and liabilities, encouraging companies to be increasingly proactive in the management of their financial risks.

In December 2010, the MAS issued a consultation paper on proposed legislative amendments to the **Insurance Act (Cap 142)**, attaching a draft Insurance (Amendment) Bill. The consultation paper states that the MAS does not aim to prevent failures of all financial institutions and that it is important that it has sufficient powers to act expeditiously to protect policyholders and preserve stability.

The proposed amendments to the Insurance Act have the stated aims of strengthening the insurance regulatory framework and allowing the MAS to act rapidly when faced with a failing or failed insurer.

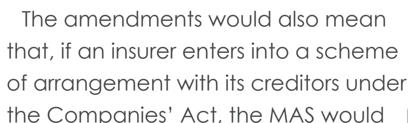
The draft bill includes key new powers for the MAS to assist it in situations where an insurer is distressed and may face liquidation. These include allowing the MAS to:

- take control of an insurer
- make a determination for the sale or transfer of ownership of assets and liabilities
- sell or transfer ownership
- apply to court for a moratorium such that no resolution shall be passed for the insurer.

FAILED INSURERS

In circumstances where an insurer is already in liquidation, the proposed legislative changes would give the MAS power to approve the appointment of a liquidator and also add, vary or revoke conditions on the liquidator.

Notably, the proposed legislation would require the liquidator to sell or transfer portfolios to other reinsurers (as far as reasonably practicable) and to continue the business of the insurer until the portfolios have been transferred.



The amendments would also mean that, if an insurer enters into a scheme of arrangement with its creditors under the Companies' Act, the MAS would

be made a part of the scheme. The consent of the MAS would also be required before such a scheme could be approved by the court.

In addition, the bill proposes repealing current provisions concerning the Policyowners Protection Scheme (which governs compensation or coverage continuity to policyholders in the event their insurer fails).

It is proposed that the existing scheme is altered with the **Deposit Insurance Act** being repealed and replaced with a new **Deposit Insurance and Policyowners' Protection Schemes Act** (which is also the subject of separate consultation).

Competency Standards Training Scheme and the General Insurance Association's (GIA) Global Internship Programme (launched in 2008).

TAX EXEMPTION SCHEMES

In 2011 the Singapore government announced that existing fiscal incentive schemes aimed at assisting captive insurers, specialised insurers and marine hull and liability insurers, which had been due to expire, were to be extended.

The captive insurance tax incentive scheme was introduced in 2006 to give tax exemption to approved captive insurance companies on specified income earned from accepting offshore risks.

The exemption was due to expire in 2011 but will now be extended up until 2018 and should continue to support Singapore's competitive position as a leading captive location internationally.

Meanwhile, the tax exemption scheme for offshore marine hull and liability insurance business was effected in February 2000. This was due to expire in 2011 but has been extended until 2016.

The scheme is available to all general direct insurance and reinsurance companies who have committed to writing offshore marine hull and liability business from Singapore and provides tax exemptions on income derived from underwriting profits from such business.

Meanwhile, the offshore specialised risks incentive scheme has also been extended to 2016. The scheme is aimed at expanding the underwriting of certain specialised lines of business in Singapore, including terrorism risks, political risks, energy risks, aviation and aerospace risks. This scheme has also now been expanded to include agricultural risks.

It grants exemption to approved insurers on specified income earned from accepting offshore risks in these specialised lines.

WEATHERING THE CRISIS

Banks and insurance companies have weathered the storm of the financial crisis reasonably well, despite the deepest recession since independence. This was assisted by the bounce back of the Singapore economy as a whole, which grew 14.5% in 2010.

The financial stability review published by the MAS's Macroeconomic Surveillance Department in November 2009, concluded that Singapore's insurance sector capital positions remain healthy and that "premium

growth trends suggest that general insurers in Singapore have not been significantly affected by the economic slowdown, except where the insurance business pertains directly to economic activity that has seen a decline (for example, marine cargo)".

Singapore however did not escape issues brought on by the crisis, such as the mis-selling of structured investment products by financial institutions.

Nearly 10,000 people in Singapore purchased Lehman linked 'mini-bonds' whose value was eradicated when the investment bank collapsed.

Of those affected, thousands were offered compensation for their losses directly by the financial institutions and many complaints raised by investors were resolved through mediation. Only three suits appear to have been filed with the Singapore High Court in connection with the sale of such products.

STRUCTURED PRODUCTS INVESTIGATION

The MAS also acted promptly following an investigation into whether financial institutions failed to follow guidelines on the sale of structured products. This resulted in three banks, six regional brokerages and a finance company being prohibited from selling structured notes to retail investors for periods ranging from six months to two years.

The episode prompted a number of reforms in consumer financial services. In April 2009, the MAS issued Guidelines on Fair Dealing – Board and Senior Management Responsibilities for Delivering Fair Dealing Outcomes.

Its aim was to promote fair dealing on the part of financial institutions in the conduct of their business and to build consumer confidence.

The guidelines call upon financial institutions to review the manner in which they deal with their customers to ensure they deal with them fairly and set a number of "fair dealing outcomes", which include financial institutions offering products and services that are suitable for their target customer segments.

In terms of risk management, the MAS also recently announced that local banks and "significant insurers" must have dedicated risk management committees "plugged in" to the risk-taking activities of the firm.

These developments are in parallel with (but will serve to reinforce) major insurers reporting significantly growing books of business in financial lines products including directors and officers' liability cover. Around 90% of publicly-listed companies in Singapore now have D&O cover, up from around 60% in 2000. ■

WEB RESOURCES

Consultation on Insurance (Amendment) Bill
www.mas.gov.sg/resource/publications/consult_papers/2010/CP_IA_Amendment_Bill.pdf

Extensions to tax exemption schemes
www.singaporebudget.gov.sg/budget_2011/speech_toc/download/annexa2.pdf

Financial institutions in Singapore
www.mas.gov.sg/fi_directory/index.html

Reform of the Spanish Criminal Code

THE ISSUES: What are the implications for those insurers providing D&O coverage in Spain in light of recent regulatory change? Is a potential increase in limits and pricing of policies likely?

DUE TO A SIGNIFICANT REFORM of the Spanish Criminal Code (SCC), which came into force on December 23, 2010, companies in Spain, with the exception of Government-owned entities, may now, for the first time, be held criminally liable for certain crimes committed by their directors or employees.

Companies can now be held liable in the following cases:

- for crimes committed in their name and for their benefit by persons authorised to act on their behalf. For example, legal representatives, directors and de facto directors
- for offences committed for their benefit by employees performing their functions where there has been inadequate control or supervision by the company over such employees.

Under the new rules the criminal liability of the individual and that of the company, remain independent of each other, hence the absence of liability on the part of the individual does not rule out the possibility of holding the company criminally liable.

The criminal responsibility of directors is regulated by **Article 31.1 of the SCC** which has not been altered. As noted above the law made, and continues to make, directors personally liable. The extension of criminal liability to companies (**set out in Article 31.bis**) is in addition to any criminal liability that may be incurred by those managing a company.

The Spanish Criminal Code has been reformed

OFFENCES IN QUESTION

The offences for which a company may be held liable are many and include bribery and corruption, money laundering, falsification of financial information and environmental breaches, amongst others.

However, there are some exceptions, for example, in the case of work-related incidents, companies cannot be criminally liable, only individual executives. The key point to note is that the new rules have criminalised several types of conduct previously incurring only administrative

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WIDENING THE SCOPE OF CRIMINAL LIABILITY

WIDENING THE SCOPE OF CRIMINAL LIABILITY

There has been agitation in the Spanish insurance market about the reform and its impact on the potential liability of directors and officers and it is yet to be seen how the insurance market will react to the changes...

OBVIOUSLY THE REFORM of the Spanish Criminal Code (SCC) considerably widens the scope of criminal liability: by including companies themselves for the first time; by extending the range of offences for which the directors and officers of companies can be held liable; and by the increased severity of the penalties.

However, it is clear that losses resulting from acts perpetrated in **bad faith** by the insured are excluded from D&O coverage (**Article 19, Insurance Contract Act 1980**). To that extent, the coverage position for directors and officers remains unchanged since **intentional** criminal acts or omissions are not covered. Certain policies in the Spanish market do cover certain items (as administrative fines) although, according to the law, fines cannot be covered by insurance.

What is, therefore, the real impact of the new criminal context on D&O policies?

Arguably, the new crimes with which companies can be imputed and the new ways of committing already existing crimes may lead to an increase in criminal litigation both against companies and against directors and officers.

Claimants favour criminal proceedings as they exert an undoubted pressure on defendants and allow for wider investigations.

In the case of the directors and officers, defence costs are usually advanced in the course of litigation. Although this is no novelty, it is likely that the sums involved will be higher if, as expected, proceedings become more frequent.

Some carriers, particularly where small and medium-sized companies are concerned, are providing a pre-determined allocation of defence costs with a 20% deductible for the defence of claims against the company and the directors.

They require a joint defence for the company and the directors which, in the new criminal scenario, could lead to conflicts between the company and the directors.

Under normal conditions defence costs are reimbursable to the insurer if the insured is convicted for an intentional crime. There are, however, policies in the market that waive this requirement.

Further, two types of bonds (fianzas) may have to be set up in the framework

of criminal litigation: bail and civil bonds, the latter to cover the civil liability arising out of the criminal offence.

This is not a novelty either, but again the sums involved may have to be increased in response to the new crimes and the increased severity of penalties which, in turn means increasing the policy limits.

INSURABILITY OF FINES

Fines can be of a civil, regulatory (administrative) or criminal nature. The general position in Spanish law is that the insurability of fines is contrary to public policy and, that, since penalties specifically relate to the individual upon whom they were imposed, they cannot be "passed on" to another person.

This is the official position of the Insurance Supervisory Authority. In fact, the new **Draft Bill of the Insurance Contract Act** makes void clauses seeking to provide cover in respect of criminal or regulatory penalties. There are arguments, however, to allow the insurability of fines:

- in the case of fines imposed for criminal conduct, which will be the usual case when companies and directors are convicted, certain crimes, committed without intention (i.e. by serious imprudence), as identified in the SCC, should perhaps be an exception to the general rule
- in the case of regulatory fines, the principle of proportionality requires the authorities to consider the existence or degree of intent. This suggests that fines for negligent, rather than intentional, conduct are possible and if this is so, there would be some basis to understand that this type of fine is insurable.

However, given the ruling by Spain's insurance regulator, to the effect that any clauses attempting to insure financial penalties imposed for criminal conduct (even where no intention has been proved) will be void, to be confirmed by the forthcoming Insurance Contract Act, it is unlikely that the official position will change.

COVERAGE ISSUES

Insurers will need to consider what sort of cover they can provide to protect companies in the new criminal framework.

Could they cover legal expenses incurred by companies as well as other issues, such as, loss of revenues in circumstances where a company is held criminally liable and the act is proved to be intentional?

D&O policies do not seem to be the adequate vehicle since they are intended for the protection of directors' assets. Even the coverage of legal expenses incurred by the company

may prove problematic in the very likely scenario that conflicts arise in the joint defence of the company and its directors. Perhaps a general civil liability may be the adequate response to companies' needs.

To conclude, the criminalisation of companies, the new criminal offences and the increased severity of penalties for companies and directors have increased the risk of litigation. It would not be surprising if this state of affairs leads to an increase in limits and pricing for D&O policies.

penalties. In addition, penalties have been made more severe.

However, criminal liability is only established provided that the criminal offences are as a result of a lack of "due control" exercised by the company over the relevant employees. As a safeguard, and to avoid potential liability for the actions of such persons, companies should establish codes of good practice, crime prevention and compliance programmes and, in addition, adopt or adapt internal controls and risk management practices in order to comply with the new legislation.

For example, employees could be trained on bribery and corruption laws and codes of good practice and audits should be periodically carried out to ensure the controls implemented are effective. This can help with the company's defence since, where a company implements controls to prevent crime, the court will consider this as a mitigating factor when ruling on criminal liability.

JOINT LIABILITY

If a company is held to be criminally liable, it may also be found liable under civil law. Formerly, the company as a general rule could only be held civilly liable, never criminally liable. However, a company could be held liable on a joint and several basis for the payment of fines imposed on directors who were held to have committed criminal acts (**under paragraph 2 of Article 31 of the SCC, now repealed by the reform**) but companies never faced criminal liability.

The reform however imposes penalties in cases in which a company could be considered criminally liable, ranging from fines, a temporary suspension of activities, closure of the company's premises, a permanent ban on carrying out any of the activities in which the crime was committed, prompted or concealed, through to, in the most serious cases, the dissolution of the company. ■

WEB RESOURCES

Underwriting agencies
www.dgsfp.meh.es/profesionales/Agenciassuscripcion.asp

Judiciary power
www.poderjudicial.es/eversuite/GetRecords?Template=default

Justice Ministry
www.mjusticia.es/cs/Satellite/es

Zurich: The trend of moving reinsurance business to Switzerland was originally started by companies with large exposures in the US

Redomestication and establishment of reinsurance carriers

THE ISSUES: An examination of the Swiss taxation regime from an insurance company perspective. How might the regulation of the country's insurance intermediaries alter in the future?

SWITZERLAND HAS long been, and remains, an important centre for the reinsurance industry for a variety of reasons. Both the movement of existing businesses from offshore centres to Switzerland and the establishment of new businesses in the country continue to be hot topics in the reinsurance world.

The trend of moving reinsurance business to Switzerland was originally started by companies with large exposures in the US.

Global insurers have been able to lower their US tax exposure fairly simply. To

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WHO PAYS THE BROKER?

WHO PAYS THE BROKER?

The envisaged regulation of brokers' remuneration in Switzerland...

THERE ARE SOME peculiar aspects to working as an insurance broker. One is that, although the broker acts in the interest of the policyholder, he is not normally remunerated by his client. Instead, the broker is paid a commission by the insurer with whom he makes the contract on behalf of his client. The insurer retrieves the broker's commission as a part of the premium to be paid by the policyholder. At first glance this practice has only advantages for all involved parties:

- it relieves the policyholder from the duty to pay "his" broker by way of a up-front lump-sum fee in addition to the insurance premium
- the insurer benefits because it facilitates the sale of insurance products, since no policyholder will be prevented from concluding an insurance contract by a high up-front payment
- the broker does not have to discuss the adequacy of the remuneration with his client.

At second glance, however, brokers can be subject to significant conflicts of interest when, for instance, their remuneration and inducements are higher for selling a certain insurance product as compared with another product. Consequential disadvantages for the policyholder cannot be excluded.

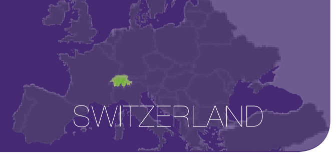
CURRENT REGULATION

The regulation of insurance intermediaries is currently set out in **Art 40 et seq of the Swiss Insurance Supervisory Act** *(Versicherungsaufsichtsgesetz, "VAG")*, which has been in force since 2006. It provides for mandatory registration in a public register by brokers and for optional registration by tied agents. It sets out information duties that mainly follow those of **Directive 2002/92/EC (Insurance Mediation Directive, "IMD")** and, in addition, obliges intermediaries to take out professional indemnity insurance. Further regulation does not apply.

DRAFT VVG

A draft law for a revised **Insurance Contract Act** as of January 21, 2009 (*Entwurf des Bundesgesetzes über den Versicherungsvertrag, Draft-VVG*), intends, *inter alia*, to eliminate possible conflicts of interest for the broker resulting from the current remuneration practice.

Art 68 Draft VVG provides that the policyholder shall remunerate the broker. Eventual (additional) commission payments by the insurer shall remain



admissible, however, the broker shall refund any such commission, and other monetary benefit received, to the policyholder. The policyholder can only waive the entitlement to, such refund in so far as it can be offset against the remuneration he owes the broker. If the commission received by the insurer is equal to the remuneration owed to the broker, such setting off has the effect that no "real" payments from the policyholder to the broker have to be made, but rather that such remuneration is an accounting position. Art 68 Draft VVG is mandatory as long as the policyholder is not a "large risk". Collateral information duties to be imposed on the broker shall be set out in the VAG.

OBJECTORS TO THE DRAFT REGULATION

Predominantly brokers' organisations take the position that Art 68 Draft VVG is an unreasonable restriction of economic liberty, which is guaranteed by the Swiss Constitution. Further they maintain that the draft regulation is incompatible with EU legislation, since the IMD does not set out any rules on brokers' remuneration either.

Certainly it is true that compatibility with European legislation is desirable for the Swiss marketplace. While emphasising this desirability, however, it should be kept in mind that one of the major aims of the ongoing revision process of the IMD is to eliminate potential conflicts of interest and lack of transparency in brokers' remuneration. Thus, it remains to be seen how the Swiss legislator and the EU legislator will finally address these issues and whether the outcomes will be compatible.

achieve this benefit a primary insurer writing insurance business in the US would cede a large portion of its risks to an affiliated reinsurer based in an offshore and "tax-friendly" jurisdiction, such as Bermuda, and pay a substantial reinsurance premium to that reinsurer.

Any profits on the business ceded would be, from a corporate group perspective, made mainly in Bermuda, where no taxes are levied on earnings.

NEAL BILL THREAT

US Congressman Richard Neal has made a number of attempts in the US over the years to dam this flow, so removing the tax advantages which some see as a loophole.

If the so-called "Neal Bill" does eventually pass through Congress, it would disallow deductions for a portion of reinsurance premium if those are paid directly or indirectly to an affiliated reinsurer that is not subject to US federal income tax.

Subsequently, Switzerland has become a popular destination for reinsurers that are leaving, or thinking of leaving, certain offshore jurisdictions in anticipation of the potential new tax regime.

The process is known in Switzerland as re-domestication, since, under Swiss corporate

law, it is possible to move a foreign-domiciled company into Switzerland without dissolving it.

Technically speaking, most of the operations that have moved into Switzerland have done so by way of an international merger, which is also permitted under the **Swiss Merger Act**.

SWISS TAXATION SITUATION

More and more multi-national insurance groups intending to enter the European market are considering Switzerland as a possible home with the taxation advantages on offer an important driver for the decision-makers. The current tax issues in Switzerland are as follows:

EXCISE TAX: Those Swiss reinsurers that do business in the US are usually exempt from US excise taxes based on the **Double Taxation Treaty** between Switzerland and the US.

The protocol to that treaty, with reference to business profits, states that the US tax on insurance premiums paid to foreign insurers shall not be imposed on insurance or reinsurance premiums that are the receipts of the business of insurance carried out by a Swiss carrier, whether or not that business is carried out through a permanent establishment in the United States.

FOREIGN PROFITS: Switzerland levies taxes only on income arising in Switzerland. If a Swiss company has a branch abroad, profits made there are, in principle, not assessed in Switzerland. If a Swiss reinsurer, for instance, maintains offices in Bermuda, profits made by the Bermudan branch are neither taxable in Switzerland nor in Bermuda, as no tax is levied on earnings there.

"DOMICILED COMPANIES": If at least 80% of the income of a company derives from foreign sources and at least 80% of the expenses accrue abroad, such a company could be regarded as a tax-privileged mixed or domiciled company.

Income from foreign business and/or investments from foreign sources are taxed at a Cantonal and communal level to the extent of 10% to 20% at ordinary rates only.

The exact percentage depends on the apportionment of the Swiss and the foreign business. Since reinsurance has always been an international business, in many cases reinsurers fall under the mixed or "domiciled company" regime. ■

WEB RESOURCES

Double Taxation Treaty between Switzerland and USA
www.irs.gov/pub/irs-trty/swiss.pdf

Revised wording of the draft Swiss Insurance Contract Act
www.efd.admin.ch/dokumentation/gesetzgebung/00571/01345/index.html?lang=de

Comments on the draft from intermediary organisations
www.svvg-fsaga.ch/svvg-aktuell/inhalte-von-aktuell/svvg-vl-zu-vvg-def-29-7-09-1.pdf

www.siba.ch/pdf/2_Gutachten.pdf

The Wall St reforms have revived the State versus Federal regulatory debate

Dodd-Frank Wall Street Reform titles

THE ISSUES: Practitioners have long-debated the potential impact of the new Federal Insurance Office, but two lesser-known provisions of the Wall Street Reform Act could also greatly affect insurers

TITLE V OF THE **Dodd-Frank Wall Street Reform and Consumer Protection Act** (the Act) has received widespread attention from commentators and the insurance industry due to its proposed creation of the Federal Insurance Office (FIO) in the US.

However, two other provisions of the Act – **Title I**, which among other things grants authority to the newly-created Financial Stability Oversight Council (FSOC) to designate certain non-bank financial companies for heightened prudential supervision, and **Title II**, which grants orderly liquidation authority (OLA) to the Federal Deposit Insurance Company (FDIC) may also greatly affect insurers.

The FSOC consists of 10 voting members (including one independent member with insurance industry expertise, to be appointed by the President) and five non-voting advisory members (including the director of the FIO) and one state insurance commissioner, to be chosen by the states).

The FIO's tasks are to monitor the insurance industry, collect data on insurance activities,

advise the FSOC on potential systemic risk by insurers, and represent the US at international insurance meetings.

To critics, Titles I and II reflect the proverbial "camel's nose in the tent"vis-à-vis a shift from state to federal regulation of the insurance industry.

Although administrative rules relating to these titles have recently been proposed, many questions regarding their implementation remain unanswered, and their ultimate impact on the insurance industry remains unclear.

SUPERVISION OF NON-BANK COMPANIES

Under Title I, the FSOC is authorised to determine whether certain "non-bank financial companies" – which includes insurance companies – are systemically significant and should be subject to prudential supervision by the Federal Reserve Board of Governors.

The standard for supervision is not necessarily whether a company is on the verge of failure, but whether the FSOC believes "that material financial distress at the [US or foreign] non-bank financial company, or the nature, scope, size, scale, concentration, interconnectedness, or mix of the activities of the…non-bank financial company, could pose a threat to the financial stability of the United States."

If the FSOC determines that it could, then the company is subject to Federal oversight to ensure, among other things, that it meets certain risk-based capital, liquidity, resolution plan, credit exposure report, and concentration limit requirements.

Dodd-Frank provides 11 criteria for the FSOC to consider in making its oversight determination, ranging from leverage, to the importance of the company as a source of credit and liquidity for the United States financial system, to the degree to which the company is already regulated by one or more primary financial regulatory agencies in the US or abroad.

In January, the FSOC released a notice of proposed rulemaking (NPR) that lists the 11 criteria and calls for their use, but which includes six additional criteria, grouped in relation to the following two questions:

- whether the company's failure would spill over and cause a "systemic threat to the financial stability of the United States"; and
- how vulnerable the company is to financial distress.

The FSOC explained the use of these six criteria would bring its approach in line with the approach currently under development by the Basel Committee on Banking Supervision and the Financial Stability Board.

It added that each of the 11 statutory criteria could be grouped under one or more of the six broader criteria but did not explain how, as a practical matter, the 11 criteria in the Act should be integrated with the six categories in the NPR.

In the end, the FSOC's NPR leaves considerable uncertainty as to the circumstances that might trigger a determination that an insurer poses a systemic risk.

ORDERLY LIQUIDATION AUTHORITY

Title II of the Act grants the FDIC additional authority to act as receiver for certain distressed financial companies. The criteria for determining whether a company is subject

to Orderly Liquidation Authority (OLA) include whether the financial company is in default, or in danger of default, and what effect the default would have on financial stability in the US.

The definition of "financial company" in Title II differs from the definition in Title I. Insurance companies are generally exempt from the orderly liquidation procedures discussed in Title II. Nevertheless, insurance companies operating in the US need to be aware of certain provisions of Title II and certain recently-proposed FDIC regulations.

First, although insurers (and the insurance affiliates of non-insurance companies) are subject to liquidation under applicable state law, subsidiaries or affiliates of insurance companies (including insurance holding companies), which are not themselves insurance companies, are subject to OLA.

This creates a potential conflict between federal and state regulators when a financial company with both insurance and non-insurance affiliates becomes subject to such a proceeding.

The FDIC's recent interim final rule (IFR) concerning certain parts of Title II, released in January, is largely silent on the parameters of federal and state authority with respect to a liquidation proceeding, although in an effort to prevent the liquidation of an affiliate subject to the OLA from interfering with the liquidation of an insurer, the IFR acknowledges that there should be some limits to the FDIC's authority to take liens on the assets of an insurer or its affiliate.

Title II also authorises federal regulators to require state regulators to commence a receivership or rehabilitation of an insurer,

"The FSOC's NPR leaves considerable uncertainty as to the circumstances that might trigger a determination that an insurer poses a systemic risk"

and even to take over the receivership after a specified period of time.

Although **Section 203(e) of Dodd-Frank** provides that a liquidation or rehabilitation of an insurer is conducted under state law, Title II provides a framework for determining whether the liquidation or rehabilitation must commence in the first place. That determination requires the approval of two-thirds of the Federal Reserve Board and the director of the FIO, but does not involve any state regulator. If, following such approval, the appropriate state regulator does not commence the required state court action within 60 days, the FDIC can commence the action in state court itself.

UNCERTAIN FUTURE

The FSOC was designed to include members with substantial insurance expertise. Yet more than six months after the passage of Dodd-Frank, the only insurance-related voting position remained unfilled (Michael McRaith, head of the Illinois Insurance Department, has accepted an offer to head the FIO, a non-voting position, and the other non-voting position is occupied by John Huff, head of the Missouri Insurance Department).

Members of Congress of both parties have asked that the FSOC delay classifying insurers as systemically risky and subject to

Insurers could be subject to Federal Reserve oversight to ensure they meet risk-based capital requirements

Title I supervision until all of the insurance-related positions have been filled. Industry representatives have expressed similar concerns.

There is considerable uncertainty as to the role state regulators will play in the coming years. John Huff, the state insurance commissioner, has stated his effectiveness on the FSOC may be limited because of confidentiality rules preventing the non-voting state regulators from discussing the Council's proceedings. Moreover, the FSOC has taken the position that Huff represents only his agency, a position that the NAIC has disputed.

The NAIC gave voice to industry frustration in its February letter to the Treasury Department, in which it stated that it has been largely shut out of the regulatory process. Though it is still early days, the insurance industry certainly

"The insurance industry certainly has reason to be vigilant as the Federal camel eases into the regulatory tent"

has reason to be vigilant as the Federal camel eases into the regulatory tent. ■

WEB RESOURCES

Dodd-Frank
www.sec.gov/about/laws/wallstreetreform-cpa.pdf.

The FSOC's Notice of Proposed Rulemaking
www.treasury.gov/initiatives/Documents/Nonbank%20NPR%20final%2001%2013%2011%20formatted%20for%20FR.pdf.

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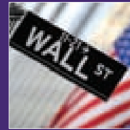

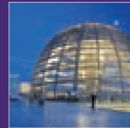
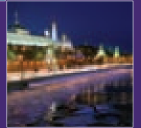
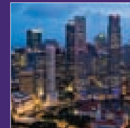

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