The City of London Law Society

4 College Hill
London EC4R 2RB
Tel: 020 7329 2173
Fax: 020 7329 2190
www.citysolicitors.org.uk

Response

Comments by the City of London Law Society, Insurance Law Committee on HM Treasury's "Proposals to implement the Reinsurance Directive"

These comments represent the views and opinions of the Insurance Law Committee of the City of London Law Society. The members of the Committee are Ian Mathers of Allen & Overy (Chairman); Martin Bakes of Herbert Smith; Christian Wells of Lovells; Michael Mendelowitz of Norton Rose; Stephen Lewis of Clyde & Co; Geoff Lord of Kennedys; Kenneth McKenzie of Davis Arnold Cooper; James Bateson of Norton Rose; Martin Mankabady of Lawrence Graham; Maxine Cupitt of CMS Cameron McKenna; Richard Spiller of Kendall Freeman; Paul Wordley of Holman Fenwick & Willan; Glen James of Slaughter & May; Terry O'Neill of Clifford Chance; Charles Gordon of DLA Piper; Catherine Hawkins of Berrymans Lace Mawer; and Anna Tipping of Linklaters.

Introduction

The City of London Law Society, Insurance Law Committee, welcomes the opportunity to comment on HM Treasury's consultation paper "Proposals to implement the Reinsurance Directive (July 2007)". We intend to respond to the specific questions raised in the consultation paper and will make any further comments which appear relevant in the context of the questions asked. We have two further observations, which we address at the end of this paper.

Question 1 – Do you agree with the proposals for implementing the passport rights for pure reinsurance companies?

We agree that it is necessary to allow "pure" reinsurance companies to exercise their passporting rights. The logical way to achieve this appears to be, as you suggest, to include "pure" reinsurers (within the definition in the Reinsurance Directive) in a new category of "EEA Firm" as defined in paragraph 5 of Part 1 of Schedule 3 FSMA 2000. We wondered whether this opportunity might also be taken to clarify whether or not an undertaking carrying on both direct insurance and reinsurance activities is currently able to exercise passporting rights in respect of its reinsurance activities alone. It should be made clear whether Part I of Schedule 3 does or does not permit

such a firm to exercise passporting rights in respect of those reinsurance activities. In our view, paragraph 5(d) of Part 1 of Schedule 3 FSMA 2000 does not make this entirely clear though following our telephone conversation with your David Beardsworth we understand that you believe this issue will, in any event, be clarified as part of Solvency II.

Question 2 – Do you agree that a "Part VII – Lite" regime requiring only a solvency certificate could usefully be introduced for certain kinds of transfers of reinsurance business?

Before commenting on the detail of your question, we would like to confirm our understanding of your overall proposals for transfers of reinsurance business, which is as follows:-

(a) A UK authorised company carrying on both insurance and reinsurance activities will continue to be able to transfer all or any part of any of its direct insurance activities (wherever carried on in the EEA) and/or all or any of its reinsurance activities carried on in the United Kingdom in accordance with the Part VII procedure. However, where the transfer by such a company includes reinsurance business carried on in another Member State, the Courts of that Member State are not currently obliged, by any EU Directive, to recognise the order of the UK Court under Part VII. This appears to be borne out by section 116(6) FSMA 2000 and the changes which you are proposing to make to section 116. Case 2 in section 105 (as proposed to be amended) will therefore continue to leave jurisdiction for the transfer of reinsurance business in such a case with the competent authority of the host Member State where the reinsurance activity which is to be transferred is carried on.

(b) An EEA Firm carrying on both insurance and reinsurance activities will be able to transfer, under the Part VII procedure, all or any part of the reinsurance activities which it carries on in the United Kingdom. Conversely, the competent authorities of the home Member State will continue to have jurisdiction to approve the transfer of direct insurance activities carried on in the United Kingdom.

(c) A "pure" reinsurer (that is to say a company carrying on reinsurance activities exclusively and thus the subject of the Reinsurance Directive) which is headquartered in the EEA will only be able to transfer all or any part of its reinsurance business in accordance with the Part VII procedure (wherever it is carried on within the EEA) if the pure reinsurer is a UK authorised person.

We agree that, if this summarises correctly the intention behind your proposals (and specifically the wording in Schedule 1 to the Reinsurance Directive Regulations 2007), then it seems to us to achieve the purposes required by the Reinsurance Directive.

Turning now to the detail of Question 2, we were a little confused by the provisions in paragraph 2.18. At the moment, Case 4(a) provides an exemption from the Part VII procedure if the whole of the business to be transferred is exclusively that of reinsurance and all the policyholders have consented. The new Case 5 will extend this exemption to the transfer by a "pure" reinsurer of the whole or part of its business provided, again, that all the policyholders affected have consented to the transfer and provided also, in this case, that a solvency certificate is obtained. It seems to us that the effect of paragraphs (b) and (c) in the new Case 5 will restrict the exemption, in practice, to transfers of part only of a pure reinsurer's business since Case 4 will presumably apply already to the remaining area which, absent paragraph (c) of the new Case 5, Case 5 would have covered. As proposed, transfers of the whole of the business will continue to fall within Case 4. We do not understand why a solvency certificate should be required in the case of the transfer of part of a "pure" reinsurer's business, but not where the whole of that business is to be transferred, assuming, in either case, that all of the policyholders affected have agreed to the transfer.

Subject to resolving the rationale for that apparent inconsistency, we think it is in principle logical to extend the exclusion granted by Case 4 to include partial transfers (as well as full transfers) of the reinsurance business of pure reinsurers, where the consent of all cedants has been obtained. We note that the consent route under Case 4(a) is likely only to be capable of being used in practice by "pure" reinsurers because of the difficulty of obtaining consent from all direct insurance policyholders (who may be affected by the transfer, even though their policies are note being transferred).

We assume that, in the case of a partial transfer, the cedants affected by the transfer for the purposes of Case 5 will include both those cedants with contracts of reinsurance that are transferring and those with contracts that are not. In passing, and although (in light of the foregoing) it is probably largely academic, we note that there appears to be no exemption for a transfer of part of the reinsurance business of a company carrying on both insurance and reinsurance activity where all policyholders affected have consented. In theory at least, this seems illogical, though we doubt in practice that the consent route under Case 4(a) is open to anyone other than a pure reinsurer because of the likely need, and practical difficulty, of obtaining consent from the holders of all direct policies of insurance. Nevertheless, the interplay of Cases 4 and 5 is confusing and it may be better if Case 4 instead applied to "non-pure" reinsurers and Case 5 to "pure" reinsurers.

We agree that, as proposed in the amendment to section 105(4) FSMA 2000, the right of parties to apply to the Court for sanction of a transfer scheme, notwithstanding that the transaction is in the new excluded category, is sensible. The transfer of all or part of a reinsurance business, even where the cedants agree to the transfer, may involve (and indeed is highly likely to involve) the transfer of other assets and liabilities as well. Thus, it is to be expected that the transferor will have retrocession cover in place and it may be necessary for such cover to transfer both in the Case 4 and the Case 5 situation. The parties will have to rely on the Court order to effect the transfer

if the consent of the retrocessionaire has not been obtained. Similarly, the Court order may be useful in securing the transfer of the underlying assets representing the reinsurance reserves backing the liabilities which are the subject of the transfer. Accordingly, we think that cedant consent is only part of the overall picture, and it may very well be the case that, even with such consent, an application to Court to sanction the transfer is required for the above reasons.

Question 3 – What are the specific types of transfers that might be considered for this lighter touch process?

We did give consideration to the possibility that all transfers of reinsurance business (as opposed to transfers of insurance business) might be dealt with by the FSA rather than the Court, on the basis that the primary consideration, so far as cedants are concerned, is likely to relate to the security of the transferee's covenant, compared with that of the transferor, and the transferee's ability to administer and deal with the business transferred in a fair and efficient manner. These are areas which the FSA is well qualified to judge.

However, we have concluded that, whether in relation to insurance or reinsurance transfers, the Part VII process has certain unique advantages justifying its retention, even in the case of the transfer of pure reinsurance business. As indicated above, there are often other issues surrounding a transfer of reinsurance business in addition to the question of determining that cedants' interests are not adversely affected. The ability of the Court to make an order transferring retrocession agreements, the assets supporting the reinsurance reserves and the infrastructure associated with the business being transferred is, we think, properly a power which should only be exercised judicially in accordance with the procedure in Part VII and not through an administrative or regulatory agency.

Moreover, now that the FSA submits a formal report to the Court as a matter of course, the Court will have the explicit guidance of the FSA on those matters affecting a reinsurance business transfer which are within the areas of competence of the FSA as regulator. The Courts also have considerable discretion in relation to the nature of the procedures which have to be adopted in a particular case. Rather than attempt to define the circumstances where a Court application is not necessary – which we think would be a very difficult and involved task – we believe it is better, in overall terms, to retain the Part VII Court based process, with its in-built procedural flexibility, so that the applicant(s) can deal with the sort of issues we have addressed above.

Question 4 – Do you agree that the Court should have discretion to apply the publication requirement for transfers of reinsurance?

In a similar vein, we think it is sensible to give the Court discretion to determine, in particular circumstances, the nature and extent of the publication requirement for the transfer of a particular reinsurance portfolio, once the Court has sanctioned the transfer.

Question 5 – Do you agree that the Court discretion to apply publication requirements should apply to all transfers of reinsurance, not just those by pure reinsurers?

Again, we agree with this approach. The Court is able to judge, on the basis of the particular circumstances, whether a particular proposed approach to publication is appropriate.

Question 6 – Do you agree that pre-transfer publication in a business newspaper in circulation in each of the States concerned should be extended to reinsurance transfers that include EEA reinsurance risks?

In practical terms, whilst we have no objection to such a proposal, we think it is likely that most, if not all, reinsurance transfers will involve the applicant having to notify the relevant cedants. It is difficult to see on what basis an applicant transferor could argue to the Court that individual notification is not required and the Court could always then grant dispensation subject to newspaper advertising being undertaken. It is therefore for consideration whether pre-transfer publication in a business newspaper should be necessary if specific pre-transfer notification to cedants is taking place. The circumstances can be contrasted with a retail insurance portfolio transfer, where even following notification to all of the policyholders, some percentage of the addresses of holders of affected policies held in the transferor's data will inevitably be incorrect. This bears on a slightly different issue, namely the ability of the applicant to make contact with those affected by the transfer.

In the case of a transfer of business by a "pure" reinsurer, the burden on the applicant transferor will be considerably lighter than in the case of a retail insurance portfolio transfer, and is capable of being carried out with greater certainty that all affected cedants (there will be no direct insurance policyholders) have been informed. So in that context, the need for pre-transfer notification in a business newspaper seems to be questionable.

There may be a further point to consider. It is quite frequently the case that the applicant transferor will have dealt through brokers and other intermediaries in accepting the reinsurance risks and may not necessarily know the responsible employee at the cedant office to whom the pre-transfer notification should be sent (or indeed whether to send the notification to a branch or head office address). Moreover, the position can be further confused by the fact that the reinsurance treaty itself may (as is often the case) require that notifications to the cedant by the reinsurer should be handled through the broker or intermediary that placed the business with the reinsurer. It may therefore be helpful to reinsurers to know that any pre-transfer notification can and should be carried out by dispatching the notice, e.g. to the cedants' head office. This would not prevent the applicant also sending the notification to the particular party or parties with whom it had dealt in accepting the reinsurance, but it would clarify the notification requirement in relation to the formal process which, we think, would be an advantage.

Question 7 – Do you agree that pure reinsurers authorised and having their head office in Gibraltar should be able to exercise rights to establish branches in and provide services in the UK and vice versa, as is the case for direct insurers?

We have no reason to raise any objection to, or concern about, this proposal from our own experiences.

Further issues to consider

We understand that transfers of portfolios from non-UK EEA branches of non-EEA firms are not covered by the Reinsurance Directive. We assume, nevertheless, that you have taken the view that section 2(2) of the European Communities Act gives adequate power for the UK authorities, by statutory instrument, to make provision for recognition of these transfers in the UK.

We note that your consultation does not address the extent to which applicants should have to approach other parties (apart from cedants) who may be affected by a particular transfer of reinsurance business. Those with retrocession contracts with the reinsurer covering business to be transferred are an obvious example. As a matter of good practice, applicants would be well advised to notify other parties with a material interest in the proposed transfer of the intention to make the application. The Court will certainly be influenced in deciding whether or not to make an order affecting the rights of such parties by whether or not they have been given sufficient information about the transfer.

We are aware that the Treasury has recently consulted (November 2006) on proposed amendments in this area to Part VII FSMA 2000 (see the consultation paper issued in November 2006 entitled "Consultation on amendments relating to Part VII FSMA 2000 (Control of Business Transfers)"). We do not know what the current state of play in relation to that consultation is but, in case it is of assistance, we attach a further copy of our submission on that subject. Many of the points made in that submission would, it seems to us, apply with equal force in relation to a transfer of reinsurance business. We do not, for example, see any reason to distinguish, in this context, between the transfer of a retail insurance business relying on reinsurance cover and the transfer of a reinsurance business relying on retrocession cover. And, in any event, the point extends more widely to transfers of other assets and liabilities included in the insurance or reinsurance business to be transferred.

Contacts: Glen James of Slaughter & May, One Bunhill Row, London EC1 8YY (020 7090 3050); email: Glen.JAMES@SlaughterandMay.com

Ian Mathers of Allen & Overy, One Bishops Square, London E1 6AO (020 3088 4781); email: ian.mathers@allenovery.com