

Article / March 2008

Implementation of the Reinsurance Directive in the UK

In July 2007, HM Treasury published a consultation paper seeking views on its plans to implement the Reinsurance Directive (Directive 2005/68/EC) (the Directive) in the UK. This is the latest in a series of consultation papers on the issue (see the September 2006 and March 2007 issues of *Insurance Review*). The document focuses on the remaining changes to UK legislation which will be necessary to complete the implementation of the Directive. Most of these changes will be made to the Financial Services and Markets Act 2000 (FSMA) and related secondary legislation. The changes will impact on two key areas: passporting and portfolio transfers of reinsurance contracts under Part VII of FSMA.

The Directive

The Directive was adopted by the Council and the European Parliament on 16 November 2005 and came into force on 10 December 2005. Member States are required to implement its provisions by 10 December 2007. The Directive provides for the harmonisation of supervision of reinsurance firms in the European Economic Area (EEA) and is intended to remove barriers to the provision of cross border reinsurance services by EEA headquartered reinsurance companies.

A key feature of the Directive is that it extends to EEA reinsurance companies a system of authorisation and financial supervision by the Member State in which the reinsurance undertaking has its head office. The Directive applies only to pure reinsurers (ie those that only carry on reinsurance business). The reinsurance activities of those that carry on direct insurance as well as reinsurance business are covered by the directives relating to direct insurance.

Passporting

The term passporting refers to the right of an EEA firm to establish a branch or provide services in another EEA country on the basis of its home state authorisation. At present direct insurance undertakings can passport into another EEA jurisdiction but this requires notification to, and the consent of, the home state regulator (as well as of the host state regulator in the case of a branch) and compliance with any “*general good*” provisions imposed by the host state.

The Directive prescribes a much simpler passporting regime for pure reinsurers where all that is required is authorisation by the regulator in the Member State in which the reinsurance company has its head office. This enables the reinsurance firm to establish branches in, or provide services into, all other EEA

states without further process. It should be noted that the ability to passport does not extend to EEA branches of non-EEA reinsurers which will need to continue to satisfy the specific requirements of host Member States.

The consultation paper also contains proposals to allow UK reinsurers to provide services and establish in Gibraltar on the basis of their home state authorisation and vice-versa.

Reinsurance business transfers

A number of amendments to the scope of Part VII of FSMA are proposed by the consultation paper to reflect the fact that, pursuant to the Directive, the Member State in which the firm has its head office has the exclusive power to authorise reinsurance transfers by that firm. Consequently, the UK courts will no longer be able to sanction transfers by non-UK EEA firms nor will it be possible for UK authorised reinsurance undertakings to have transfers authorised in other EEA states.

Part VII lite regime

As it currently stands, FSMA excludes a transfer from the requirements of Part VII if it consists solely of the effecting or carrying out of contracts of reinsurance and all of the policyholders whose contracts are to be transferred have consented to it. This exclusion will need to be amended to bring it into line with the Directive. The Treasury proposed an alternative, lighter touch approach to the court sanctioned Part VII process in such cases. This has been described as a “*Part VII lite*” approach and under the Directive the only requirement will be the production of a solvency certificate by the competent authority regulating the EEA accepting office. Court approval of the transfer will not be required but the transferor and transferee will retain the ability to apply to court for sanction of the transfer, if desired, for example to enhance the prospects of recognition by a foreign court (such as the US Federal Court under Chapter 15 of the US

Bankruptcy Code) or to seek an ancillary court order to transfer reinsurance protections relating to the underlying portfolio.

The consultation paper sought views on whether it would be useful (and justifiable in the context of ensuring that all policyholders' interests are given consideration) to include partial transfers of reinsurance business within the Part VII lite approach in addition to transfers of the whole of the reinsurance business. This would have to be subject to certain safeguards such as ensuring that the consent of non-transferring reinsurance policyholders is also obtained. In addition, the Treasury has asked for input as to what other types of transfer should benefit from this lighter touch approach.

Pre-transfer notification and publication

The consultation paper states that notification of policyholders is important to ensure that those who have an interest in the transfer are aware of the application for a court order, and so have the opportunity to make representations about a proposed transfer if they wish. Such persons have a right to be heard by the court under the legislation. The current notification requirements (ie notification to every policyholder of the transferor and transferee, advertising in the three gazettes as well as two national newspapers in the UK) will continue to apply but for reinsurance transfers that include cedents established in EEA states other than the UK, a new publication requirement will be introduced. In recognition of the practical issues involved, the transfer will need to be publicised in one business newspaper in circulation in each of the EEA states concerned. The court would retain the power to waive this requirement. The Treasury asked for views on this approach.

Notice to policyholders about transfers

Where a "Part VII lite" approach is not used, the consultation paper proposes that the court will have the power to direct that notification of an order sanctioning the transfer of reinsurance contracts is published in the EEA states where risks are situated. This will apply to all transfers of reinsurance where a policyholder is established in the EEA and not just transfers by pure reinsurers. Publication will not be a requirement but the court will have a discretion to order it. The court may wish to use its discretion if it considers that publication of a particular transfer would help ensure recognition, or where the court otherwise believes that the publication of a transfer is necessary or appropriate.

Next steps

The consultation period closed on 17 October 2007. The Treasury is expected to respond to this consultation paper in the next few weeks. It is also expected to publish its long awaited response to its previous consultation on amendments to the legislation governing the transfer of reinsurance protections which was published in November 2006 (and closed on 26 January 2007) (for further information see the March 2007 issue (No. 64) of *Insurance Review*). Revised statutory instruments are expected to be laid before Parliament by the end of November 2007 with proposed changes to legislation coming into force by 10 December 2007.

Conclusion

As indicated above, many changes have been proposed to the Part VII procedure in the last twelve months. In this context, it should be mentioned that the FSA has also been considering its role in Part VII transfers following discussions with the Lord Chancellor about what additional steps it should take to assist the court in its assessment of such transfers. New arrangements have been proposed (which are not driven by the Directive but to aid transparency) under which the FSA will produce a report for the court setting out, amongst other things, the reasons why it did not object to the transfer under consideration.

The FSA wrote to those professional advisers routinely involved in Part VII transfers on 22 August 2007 asking them to identify any significant potential issues with the operation of the proposed new arrangements by 15 September 2007. In its letter the FSA identified a number of issues as potentially relevant and unresolved, for example, what balance should be struck between the roles of the FSA and the independent expert; how the independent expert's report should address the FSA report; at what time and how the FSA report should be made available to the applicant firms, the independent expert, policyholders and affected persons.

It is clear that the Part VII procedure will change in the near future but hopefully, at least in the case of transfers involving pure reinsurers, it may become simpler. Reports by the FSA on its decision making process should also make the process more transparent.

This article first appeared in *The Insurance and Reinsurance Review* (March 2008). It is for guidance only and is not intended to be a substitute for specific legal advice. If you would like any further information please contact:

Ambereen Salamat

Insurance and Reinsurance

tel: +44 (0)20 7556 4619

ASalamat@eapdlaw.com

This article is published by Edwards Angell Palmer & Dodge LLP and Edwards Angell Palmer & Dodge UK LLP for the benefit of clients, friends and fellow professionals on matters of interest. The information contained herein is not to be construed as legal advice or opinion. We provide such advice or opinion only after being engaged to do so with respect to particular facts and circumstances. Neither firm is not authorized under the U.K. Financial Services and Markets Act 2000 to offer U.K. investment services to clients. In certain circumstances, as members regulated by the U.K. Solicitors Regulation Authority, we are able to provide these investment services if they are an incidental part of the professional services we have been engaged to provide.

Please note that your contact details, which may have been used to provide this bulletin to you, will be used for communications with you only. If you would prefer to discontinue receiving information from the firm, or wish that we not contact you for any purpose other than to receive future issues of this bulletin, please contact ukmarketing@eapdlaw.com.

This publication may be considered "advertising material" under the rules of professional conduct governing attorneys in some states.

© 2008 Edwards Angell Palmer & Dodge LLP, a Delaware Limited Liability Partnership Including Professional Corporations, and Edwards Angell Palmer & Dodge UK LLP, a limited liability partnership registered in England (registered number OC333092), regulated by the Solicitors Regulation Authority. Disclosure required under U.S. Circular 230: Edwards Angell Palmer & Dodge LLP informs you that any tax advice contained in this communication, including any attachments, was not intended or written to be used, and cannot be used, for the purpose of avoiding federal tax related penalties, or promoting, marketing or recommending to another party any transaction or matter addressed herein.

ATTORNEY ADVERTISING: The hiring of an attorney is an important decision that should not be based solely on advertisements. Prior results do not guarantee similar outcomes.

**EDWARDS
ANGELL
PALMER &
DODGE**

One Fetter Lane
London EC4A 1JB
United Kingdom
tel: +44 (0) 20 7583 4055
fax: +44 (0) 20 7353 7377
eapdlaw.com