

Insurance business transfers in Hong Kong

With the increasing popularity of insurance business transfers in the UK, we take the opportunity to look at the insurance business transfer regime in Hong Kong.

Reasons for transfer

There are various reasons why an insurer (the transferor) may wish to transfer some or all of its insurance business or why an insurer (the transferee) may wish to acquire an insurance business. A transferor may wish to transfer its business:

- to realise the value of that business
- to release capital required to support that business
- to reduce its liabilities
- to remove an underperforming business or one which has failed to reach critical mass
- to reduce its regulatory exposure
- to refocus its activities in other areas
- to reduce its support required for that business (whether personnel, IT, capital, product development or otherwise).

A transferee may wish to acquire a business:

- to gain enhanced or accelerated access to a market
- to enlarge its policy holder base
- to achieve critical mass in conjunction with its existing business
- to gain access to product development or a different distribution network or agency force.

This article highlights some of the key issues which arise in a transfer of insurance business between two insurers. It is not an overview of all relevant Hong Kong law applicable to insurers or to the transfer of insurance businesses. Specific legal advice should be sought if such a transfer is contemplated.

The Transfer Agreement

The negotiation and agreement of a sale and purchase agreement relating to a transfer of an insurance business is outside the scope of this article. Suffice to say it is essential for the transferee to conduct a full actuarial review of the insurance business it proposes to acquire and to understand the capital and solvency demands of that business, not only from a regulatory perspective but also within the context of its own organisation or group. The impact of the transfer on the goodwill and reputation of the parties should also be given careful consideration.

It is worth noting that Hong Kong law does not provide for the merger of two Hong Kong incorporated companies or for the formal recognition of the merger of two overseas companies. Accordingly, the transfer of a business may be the only practical way to achieve an effective merger of two companies in Hong Kong.

In Hong Kong, the transfers of long term and general insurance businesses are regulated respectively under sections 24 and 25D of the Insurance Companies Ordinance (Chapter 41 of *the laws of Hong Kong*) (the Ordinance).



Section 24 of the Ordinance: Transfers of Long Term Business

Equivalence of insurers

The key issue is that the rights and entitlements of existing policy holders (both of the transferor and of the transferee in addition to those whose policies will be transferred) should not be adversely affected following the transfer. It is necessary either to ensure that the ratio of assets to liabilities to be transferred is broadly equivalent to the existing ratio of assets to liabilities of the transferee insurer or that a suitable injection of capital is made into the relevant company.

Independent actuary

An independent actuary is required to value the assets and liabilities of the transferor and transferee. He must form an independent view of that value and not be influenced unduly by the appointed actuaries and lawyers of the insurers. However, the independent actuary will work closely with those actuaries and lawyers in drafting a report on the terms of the scheme that will satisfy the court; the independent actuary must conclude in his report that none of the existing policy holders will be materially adversely affected by the transfer and the court will be heavily reliant on that report in determining whether to approve the scheme.

Counsel

A scheme to transfer long term business requires the sanction of the Court of First Instance. Accordingly, counsel must be instructed to settle the documentation and present the petition to the court. Identifying suitable counsel who can ensure that the court hearings proceed smoothly is important; a judge who feels that his time or legal costs have been wasted as a result of poorly presented scheme documents may not be willing to sanction the scheme.

Documentation

An extensive portfolio of documents will be required to effect a long term business transfer. The difficulties and costs in connection with preparing that documentation should not be under-estimated.

Transfer of proceedings

Under section 25(1)(a) of the Ordinance, the Court may also order a transfer of all the undertaking, property and liabilities of the transferor insurer to the transferee, including the continuation of any legal proceedings in which the transferor is involved. Following such a transfer of all the undertaking, property and liabilities, the transferor may then be sold or wound up and have its authorisation withdrawn.

Section 25D of the Ordinance: Transfers of General Business

A transfer of general business under section 25D of the Ordinance is rather simpler than a transfer of long term business as no application to the court is required and it is therefore not necessary to instruct counsel for that purpose. However, it is necessary for the Insurance Authority (the Hong Kong insurance industry regulator) (IA) to approve a transfer of general insurance business from one insurer to another and he will only do so if the following issues are addressed.

Hong Kong insurance business

It should be noted that, when making a transfer under section 25D of the Ordinance, only policies which constitute “*the carrying on of insurance business in or from Hong Kong*” may be included in the

transfer. The IA must be satisfied on this point and if he is not, he has no power to approve the transfer. Whether policies constitute the carrying on of insurance business in or from Hong Kong is a question of fact and will depend on various matters including the location of the parties and the risk and the circumstances of the negotiation, issue and carrying out of each policy.

Draft instrument of transfer

On a transfer under section 25D of the Ordinance, it is important to ensure that the instrument of transfer to be submitted to the IA for approval is in draft form or unexecuted. If the instrument has already been signed, the IA has no ability to determine the application so that any approval given in such circumstances would not be effective.

Notice to policy holders

A feature of a general business transfer (which also applies to long term business transfers) is the requirement to send various notices to the relevant policy holders before the IA may give his approval to the transfer. “*Policy holder*” is widely defined in the Ordinance to include a person “*to whom a benefit is due*” under the policy. Therefore, the definition of policy holder may include a beneficiary under the policy and is particularly important in group policies, such as medical or employees compensation policies, where there will only be one named policy holder (as one would usually describe the term) but there may be many persons to whom benefits are due.

Section 25E of the Ordinance requires the relevant notice to be sent to each of those policy holder beneficiaries before the section 25D transfer may be effective in respect of that person. If the transferor fails to give such notice, the transferor will not transfer the relevant insurance liabilities and will therefore continue its insurance business in this respect for which it will need to remain authorised. To avoid this situation, the transferor will need to apply to the IA for a direction regarding the identity of the persons to whom notice must be given; such a direction can usually be obtained.

Transfer of proceedings

As with a transfer under section 24 of the Ordinance, an order from the IA under section 25D can provide for a transfer of any legal proceedings in which the transferor is involved but in a general business transfer such an order cannot have the effect of transferring liabilities other than those that relate to the policies to be transferred.

Policy holder objections

Under both section 24 and section 25D of the Ordinance, a policy holder has the right to object to a proposed transfer. Grounds for objection are effectively limited to concerns over whether the transferee will have sufficient resources to ensure that the policy holder’s interests will not be materially affected (effectively that he will get paid by the transferee under his policy).

Whilst a policy holder in dispute with an insurer, for example over a declined claim, will sometimes use that dispute to object to the proposed transfer (or will use the threat of an objection as leverage in connection with his claim), the IA (or the court) should reject that objection on the grounds that the policy holder’s rights and claim will be equally valid (or invalid) against the transferee insurer.

Transfers of Businesses (Protection of Creditors) Ordinance

If the transferor and transferee are independent third parties, it will almost certainly be necessary for a notice under the Transfer of



Businesses (Protection of Creditors) Ordinance to be published. Failure to publish such a notice will result in the transferee becoming liable for all the debts and obligations, including tax liabilities, of the transferor arising out of the carrying on of the insurance business of the transferor. Whilst the transferee would be entitled to a statutory indemnity in respect of those liabilities, the value of that indemnity will be dependent on the circumstances of the transferor.

Alternatives

It is also worth noting that an effective merger of two insurance businesses can be made by novation and by reinsurance.

Novation

In limited circumstances, a merger of the businesses of two insurers can effectively be made by way of novation of the policies, subject always to the agreement of the relevant policy holders.

Reinsurance

An effective merger of the economic value of two insurance businesses can be implemented by way of a 100% reinsurance or fronting arrangement, which is a relatively simple mechanism particularly between two members of a single group of insurers.

However, since the mechanism is not a merger or a transfer of legal liability, the reinsured would remain directly liable to the underlying policy holders and must continue to be an authorised insurer in Hong Kong.

In addition, if the reinsurance or fronting arrangement is carried out by a long term insurer, it may constitute a scheme under which the long term business is “*transferred*” to another insurer which, if not sanctioned by the court, is not permitted and would therefore not be effective at law.



This article first appeared in Insurance Review (June 2007 issue 63). 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:

Martin Lister

Insurance and Reinsurance

tel: +44 (0)20 7556 4150

martinlister@kendallfreeman.com

KENDALL FREEMAN

The information in this article is of necessity general. For specific advice please consult professional advisers. The firm is not authorised under the Financial Services and Markets Act 2000 but we are able in certain circumstances to offer a limited range of investment services to clients because we are members of the Law Society. We can provide these investment services if they are an incidental part of the professional services we have been engaged to provide.

We currently hold your contact details, which we may have used to send you this publication. Please note that your contact details are used for our own communications purposes only. We do not disclose this data to any third parties. If you prefer us not to use this information for any purpose other than letting you receive this publication or you no longer wish to receive other publications, please contact marketing@kendallfreeman.com.

Kendall Freeman
One Fetter Lane
London EC4A 1JB
United Kingdom

tel: +44 (0) 20 7583 4055
fax: +44 (0) 20 7353 7377
www.kendallfreeman.com