

A further step forward for Part VII transfers

In the matter of Sompo Japan Insurance Incorporated and Transfercom Limited

This recent sanction of an insurance business transfer under Part VII of the Financial Services and Markets Act 2000 (FSMA) (reference [2007] EWHC 146 (Ch)), where only 27% of the transferring policies were governed by English law, demonstrates a willingness by the English courts to allow such schemes to proceed in circumstances where there are serious questions about their worldwide enforceability. This is encouraging for insurers and reinsurers who wish to use the Part VII procedure on books of business which include a high proportion of policies governed by the laws of other jurisdictions.

Part VII transfers

Part VII transfers, named after the facilitating provisions of FSMA, are a process by which direct insurers and reinsurers alike can transfer part or all of their books of business to another approved insurer. Often they are fashioned to tidy up group balance sheets or to transfer legacy business to dedicated run-off outfits. The relatively straightforward process requires that, after initial directions from the court, explanatory information on the proposed transfer is circulated to affected transferring and non-transferring policyholders. Court sanction of the transfer is mandatory and while objecting policyholders are given an audience before the court, unlike schemes of arrangement their approval is not required.

The oversight of the English court, which possesses wide powers of discretion as to whether to sanction a proposed transfer, coupled with the role of the industry regulator, the Financial Services Authority (FSA), provides protection for the rights of policyholders. The FSA is closely consulted throughout the preparation and implementation of the transfer and considers particularly the effect on the interests of policyholders. In addition, an independent expert must be appointed to report on the terms of the proposal on both transferring and non-transferring policyholders.

Sompo's internal re-organisation into the UK

The case concerned Sompo Japan Insurance Incorporated (Sompo Japan) and a proposed transfer of its insurance business which included a significant number of policies not governed by English law.

Prior to the proposed Part VII business transfer, Sompo Japan, formed by the 2002 merger of Japanese insurance heavyweights Yasuda Fire & Marine Insurance Company and Nissan Fire & Marine Insurance Company Limited, had transferred business predominantly written in Japan on an operational basis to its UK branch (Sompo UK). The effect of the transfer of this business to the UK entity was to bring it within the scope of FSMA.

Transfercom

Once the internal operational transfer had been completed, a Part VII insurance business transfer was proposed between Sompo UK and Transfercom, a UK subsidiary of National Indemnity Company (NICO) which is a member of the Berkshire Hathaway group. The transfer involved both insurance and reinsurance business written between 1950 and 2000, including policies with substantial asbestos claims and significant exposure to the World Trade Centre



loss. The transferring liabilities, net of reinsurance, stood at US\$174 million. Assets transferred by Sompo UK to Transfercom, as part of the deal, were to be used as premium to put in place US\$482 million of reinsurance cover and to provide insurance of up to \$50 million for the internal costs of running Transfercom, with both policies being provided by NICO. The reinsurance and insurance cover was intended to provide 100% protection for Transfercom.

As Transfercom was set to have a share capital of US\$43 million, the reinsurance policy would constitute the company's major reserve asset. It was therefore important that the adequacy of that reinsurance to meet potential liabilities of the transferring policies was demonstrated to the court. The policy contained a clause that provided NICO could not avoid the policy on grounds of misrepresentation or non-disclosure, and further that the policy could not be avoided by either party for any reason whatsoever bar internal fraud by Transfercom.

Doubts raised

At the sanction hearing of the transfer, Mr Justice David Richards was principally concerned about the worldwide enforceability of the proposed transfer. While much of the transferring business had been placed in the London market, it had been written in Japan and many of the policies were held by overseas policyholders and were not governed by English law. The court questioned whether by sanctioning the Part VII transfer it would be acting in vain. In effect, it asked whether the transfer would be a hollow, unenforceable act as it potentially would not be recognised in many foreign jurisdictions.

To address the issue, Sompo UK presented to the court the results of a review of a sample of 35,000 policies. It found that:

- 27% of the relevant policies, by both number and value, were governed by English or other UK law
- 30% of the policies, representing 11% by value, were governed by the law of another EEA State
- 21% of the policies, representing 60% by value, were governed by the law of various US States
- only a small number of the transferring policies were governed by Japanese law or held by Japanese policyholders.

Enforceable abroad?

Sompo UK also presented evidence on the likelihood of the relevant overseas jurisdictions recognising the effect of the transfer proposed. It argued that the transfer would be enforceable

in Europe by virtue of EC Judgments Regulation (EC No 44 of 2001). However, no ruling was given on this point.

Expert evidence on US law was also put before the court which suggested that where policies had been placed through the London market, regardless of the fact that the policies were governed by the law of a US State, the Part VII transfer would be recognised in US courts. Even if it was not enforceable in the US, it was noted that Sompo held relatively few assets there. This would mean that there would be little point in a policyholder or cedant bringing a claim against Sompo (rather than against Transfercom, as it would have to do if the transfer scheme was being recognised) as there would be few assets in the US against which to enforce any judgment. Vitality for Sompo, the majority of the company's assets were located in Japan. A legal opinion on Japanese law advised that there would be no reason for the transfer to be disregarded by a Japanese court, even where policies were governed by laws other than Japanese, English or US.

In addition, Sompo UK argued that the fact that the court's sanction may not have effect worldwide in relation to all policies, was not sufficient reason for the court to decline the transfer. It argued that sanction should be refused only in circumstances where it would serve no purpose at all and, as the evidence before the court demonstrated, that was not the case here.

Sanctioned

While Mr Justice David Richards was "*less than convinced that the scheme once sanctioned will definitely be effective as regards proceedings in foreign jurisdictions to enforce claims under the policies which are governed by foreign law*" the scheme was sanctioned. In his view the scheme would "*achieve a substantial purpose*" in that it would be effective in relation to over 27% of the relevant policies.

Furthermore, more generally, he noted that in relation to business transfers with a significant proportion of international business "*the fact that the scheme also extends to a larger class of business not governed by English law*" was not in his view "*a good ground for refusing to sanction the scheme*".

A further advance for business transfers

Since their introduction by FSMA in 2000, over 100 Part VII transfers have been sanctioned under the Act. Combined with the availability of solvent schemes of arrangement under section 425 of the Companies Act 1985, these restructuring tools have made the UK an attractive location for insurance companies seeking to rationalise their corporate structure and books of business. The *Sompo UK* ruling may assist the UK in further developing its role as a hotspot for insurance and reinsurance companies looking to restructure portfolios with a foreign element.



The scope of the judgment may also prove relevant in terms of its applicability to solvent schemes. As English solvent schemes are also not automatically recognised in foreign jurisdictions, this judgment is likely to be used as a precedent for the level of recognition required to persuade a court that a scheme is sufficiently viable to be sanctioned.

Useful though this judgment is, it also demonstrates the significant volume of evidence the court will require when considering a multi-jurisdictional business transfer scheme.

Gathering such evidence – which in this case included a survey of 35,000 policies and expert legal advice on US and Japanese law – is likely to increase significantly the costs of a transfer.

That caveat aside, as insurance business transfers become more common, it is likely that there will be a growing trend for overseas based insurers to transfer business into the UK. If the level of enforceability set in the *Sompo* transfer is accepted in further transfers, the appeal of restructuring international books of business in the UK is likely to continue to increase.



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