CLYDE&CO

Run-off update

January 2008

1) ARC Awards

We were pleased to be Highly Commended for Run-Off Advisory Services Provider of the Year at the recent ARC awards, organised by Run-Off and Restructuring Magazine. This was in recognition of our dedicated run-off team which is able to offer the full range of advisory services from litigation to corporate finance.

2) Implementation of the Reinsurance Directive in the UK

The Reinsurance Directive, approved by the European Parliament on 7 June 2005 and intended to establish a legal framework for the regulation and prudential supervision of reinsurers with a head office in the European Union, was required to be implemented in all Member States by 10 December 2007. It applies only to reinsurers which carry out reinsurance to the exclusion of direct insurance business and does not apply to mixed insurers.

The FSA has already taken certain steps to implement the directive in the UK. On 31 December 2006 it introduced prudential changes for insurers which included the introduction of a principles-based approach to asset admissibility, the reduction of certain reinsurance solvency requirements and the authorisation and supervision of insurance special purpose vehicles.

Three recent statutory instruments are a further step in implementing the directive. We summarise below their effect. All three instruments came into force on 10 December 2007. (The rest of the implementation is achieved through existing provisions of the Financial Services and Markets Act 2000 and its accompanying secondary legislation and through rules made by the FSA under powers available to them under FSMA.)

a) The Financial Services and Markets Act 2000 (Reinsurance Directive) Regulations 2007 No. 3255

This provides that a proposed transfer by a reinsurance undertaking must be publicised and notified to policyholders. That requirement can be waived by the court in certain circumstances.

b) The Financial Services and Markets Act 2000 (Reinsurance Directive) Order 2007 No. 3254

This makes clear that the term "a relevant reinsurer" (as used in Statutory Instrument No. 2001/544) includes reinsurers that fall within the Reinsurance Directive, as well as other foreign reinsurers. The instrument also deals with Gibraltar-based firms, extending to Gibraltar-based firms carrying on reinsurance within the meaning of the Reinsurance Directive the right to establish branches in the UK, which Gibraltar-based firms carrying on direct insurance business already had.

c) The Reinsurance Directive Regulations 2007 No. 3253

This provides a new procedure for certain reinsurance transfers. It was already possible, prior to the Reinsurance Directive, to transfer reinsurance portfolios under Part VII of FSMA, but certain changes were required to the UK procedure in order to comply with the Reinsurance Directive and in particular the need for home state authorisation of transfers by UK branches of pure reinsurers. In addition, the Treasury has chosen to simplify the Part VII process as it applies to reinsurance transfers, so that where the consent of all the policyholders has been obtained, an application to court will not be

necessary, although a solvency certificate (which is a minimum requirement under the Directive) will have to be obtained. There is also provision to clarify the application of the requirements for certificates as to solvency and consent of certain regulators to transfers by non-EEA insurers with a branch in the UK, and to transfers to branches of non-EEA insurers elsewhere in the EEA.

Further provisions set out rules permitting UK firms to establish in, and to provide services into, other EEA States on the basis of their UK authorisation and for EEA-based firms to do the same in or into the UK. There also provisions relating to reinsurers providing a service which is not a regulated activity under the Financial Services and Markets Act 2000 and the accounting treatment of ISPVs.

3) Issues to look out for under the Reinsurance Directive

As mentioned above, the Reinsurance Directive applies only to reinsurers that carry out reinsurance to the exclusion of direct insurance business and does not apply to insurers that carry out both insurance and reinsurance. Much will depend on the legislation enacted in each EEA state but a possible result is that an insurer which wrote both insurance and reinsurance business will not be able transfer its reinsurance business to another insurer.

Similarly, insurers that carry out insurance and reinsurance business cannot rely on those provisions in the Directive that require recognition of home state authorisation throughout the EEA. Accordingly an issue arises as to whether such an insurer, if it was incorporated and authorised in the UK, would be required to obtain local authorisation to underwrite reinsurance business in other EEA jurisdictions This is an issue facing a number of UK authorised insurers.

4) Deutsche Ruck transfers run-off to the UK

In October, Deutsche Ruckversicherung A.G. transferred all its third party run-off reinsurance business to its UK subsidiary. This is believed to be the first transfer to take place under the new German Insurance Supervisory Act which was brought into force in June as part of Germany's implementation of the Reinsurance Directive. Germany previously had no legislation in place which provided for the transfer of books of reinsurance business, although it was possible to transfer direct insurance business.

It is possible that other EU companies may now use the legislation giving effect to the Reinsurance Directive in their countries to carry out transfers of reinsurance business to the UK to take advantage of the skills and procedures available in the London run-off market. However, one limiting factor in the case of German transfers (and possibly transfers from other EU countries) is that the implementing legislation does not provide for the transfer of any retrocessions protecting the reinsurance book. Unless the reinsurance book has been written for net account, it will therefore be necessary to consider commuting or novating any retrocessions to realise/preserve their value. The same applies in relation to transfers of direct business, where reinsurance protections are not transferable with the direct book.

Further information

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