

FOREIGN INSURERS AND REINSURERS DOING BUSINESS IN THE UK AND EUROPE: SETTING THE RECORD STRAIGHT

(FORC Journal: Vol. 19 Edition 1 - Spring 2008)

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WTO/GATS Agreement

GATS is The World Trade Organisation General Agreement on Trade in Services. GATS was signed in 1995 and covers international trade in services including the provision of insurance and reinsurance. Signatories included all members of the WTO, which include the U.S. and the EEA Member States.¹

GATS allows services to be provided through a number of methods including "cross-border trade," which is defined as a service provided from the territory of one country into the territory of another. Each GATS signatory has been obliged to make commitments in relation to the relevant services in its jurisdiction that would be opened up to the other signatories. Within the EEA, it has been agreed under GATS that non-EEA insurers, e.g., U.S., Bermuda and Swiss insurers, could provide (as a principal, through an intermediary or as an intermediary) marine, aviation and transport insurance (MAT Insurance) and that non-EEA reinsurers could provide reinsurance throughout the EEA on a cross border trade basis.² Non-EEA insurers and reinsurers have also been given the right under GATS to establish a commercial presence in EEA Member States, subject to any terms, conditions and procedures for authorisation in each jurisdiction.

It is also obligatory for GATS signatories to state in their national law any limitations to those commitments. In other words, notwithstanding the principles of freedom of services enshrined in GATS, it remains permissible to apply national law to regulate services, e.g., insurance and reinsurance, for prudential reasons or to ensure the integrity and stability of the financial system, provided that such domestic regulation is administered "in a reasonable, objective and impartial manner."

In relation to the supply of MAT Insurance, a number of specific limitations have been imposed by some other EEA states that limit the ability of non-EEA insurers to provide MAT Insurance in accordance with the cross-border trade provisions of GATS. For example, in Austria, compulsory air insurance can only be provided by an EEA authorised subsidiary or an Austrian branch of a non-EEA insurer. Other Member States simply require notification that business is being conducted in that jurisdiction on a GATS basis.

At the time of GATS negotiations, reinsurance was not regulated in the vast majority of EEA Member States. There were, therefore, in those jurisdictions, very few specific limitations relating to the cross border supply of reinsurance. Some Member States, e.g., Germany, permitted the provision of reinsurance by non-EEA reinsurers on a "correspondence" basis only, that is, no presence or activity in Germany itself (including activity by brokers) and all communication only by correspondence. Other Member States, namely France, Spain and Portugal, imposed collateral requirements on all foreign (EEA and non-EEA) reinsurers.

Some jurisdictions, such as the UK, fully regulated reinsurance at the time of the GATS negotiations. The regulation of reinsurance in the UK (and in certain other EEA Member States) was imposed on the basis that this was permissible under GATS as such regulation is required for prudential reasons or to ensure the integrity and stability of the financial system.

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Regulation of Insurance

The EU Insurance Directives³ implemented a regime throughout the EEA for the authorisation and supervision of direct/primary insurers and reinsurers who also carry on insurance business, setting out a minimum set of rules and standards aimed at protecting policyholders, e.g., through minimum solvency requirements. Each EEA Member State has implemented the directives so that an insurer must have authorisation to carry on business in that state or be exempt from the authorisation requirements. GATS provides exemptions to these requirements in respect of MAT insurance.

The insurance directives give insurance companies headquartered in an EEA Member State the freedom to establish a physical presence, e.g., a branch, in other EEA Member States and the freedom to provide services (without establishing a physical presence) in the territory of other EEA Member States where they wish to conduct insurance business. These principles of freedom of establishment and freedom to provide services are two of the so-called fundamental freedoms which are central to the EEA internal market. These freedoms are referred to as "passporting."

Procedures are in place relating to the notification and (in the case of establishing a branch) approval of passporting by the home state regulator. Passporting firms continue to be regulated by their home state regulator, but the host state is entitled to impose "general good" conditions in relation to their business in the host state, that is, domestic rules with which the passporting firm has to comply but which are justified on the basis that they are for the general good.

Regulation of Reinsurance

The EU Reinsurance Directive applies to pure reinsurers and was required to be implemented by EEA Member States by 10 December 2007. However, not all have done so, including France and Italy. The key provisions include:

- requirement for every EEA reinsurer to be authorised and regulated in the EEA Member State in which it has its head office;
- implementation of an EEA-wide supervisory regime;
- permission for EEA authorised reinsurers to carry on business throughout the EEA under the freedom of establishment and freedom to provide services in the same way as insurers; and
- abolition of collateral requirements for EEA (but not non-EEA) reinsurers (from 10 December 2008).

Non-EEA Insurers and Reinsurers

Now that reinsurance is regulated throughout the EEA, all EEA Member States, although they must consider their obligations under GATS, will, when transposing the Reinsurance Directive, have to impose limitations on the cross border supply of reinsurance as the directive takes precedence over GATS. It is no longer possible for a non-EEA reinsurer to carry on business in an EEA Member State without ensuring that it is doing so in compliance with the local authorisation and regulatory requirements in that jurisdiction. For example, in the UK, the cross-border supply of reinsurance into the UK is only permissible if it does not constitute the carrying on of a regulated activity in the UK.

For those reinsurers operating in EEA Member States which before the Directive did not regulate reinsurance or which had minimal regulation of reinsurance, the impact is likely to be significant. The Directive prohibits non-EEA reinsurers receiving more favourable treatment than EEA reinsurers,⁴ which means that the regulatory burden for non-EEA reinsurers must at least be equivalent to those for EEA reinsurers. The passporting rights set out in the Directive will not be available to non-EEA reinsurers or to branches of non-EEA reinsurers. Furthermore EEA Member States may continue to impose collateral requirements on

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non-EEA reinsurers and are not required to permit insurance business transfers to or from non-EEA reinsurers (although the UK does permit this).

Regulated Activities in the UK

Carrying on reinsurance business has been regulated in the UK for many years in the same way as insurance business. The rules governing carrying on insurance or reinsurance business in the UK are set out in the Financial Services and Markets Act 2000 (FSMA). The Financial Services Authority (FSA) is the body responsible for the authorisation and supervision of insurance and reinsurance in the UK.

The fact that a policyholder or a risk is situated in the UK does not by itself mean that an insurer or a reinsurer requires FSA authorisation. Rather, the requirement for authorisation is based on the carrying on of a regulated activity by way of business in the UK (subject to any exclusions or exemptions).⁵ Breach of the authorisation requirement is a criminal offence and can result in fines and/or imprisonment.⁶

The principal regulated activities relevant to insurance and reinsurance are "effecting" or "carrying out" contracts of insurance or reinsurance as principal.⁷ There is no statutory definition in the UK of the activities which will constitute the effecting or carrying out of a contract of insurance or reinsurance, and so it has been left to the English Courts to determine the issue. The case law is summarised below:

- Effecting covers more than executing the contract. It includes the offering of insurance or reinsurance services (even if no contract is concluded) and negotiation of contractual terms.
- Carrying out contracts of insurance or reinsurance includes receipt of premiums, payment of claims and other administrative functions.⁸
- The fact that a contract is executed or policy issued offshore or that underwriting decisions are taken offshore is not conclusive of business having been conducted offshore.⁹
- An offshore insurer or reinsurer may also be effecting or carrying out a contract of reinsurance in the UK if the contract is entered into or carried out through an agent in the UK.¹⁰ The Courts have held that each of the following activities of an agent in the UK can constitute the effecting or carrying out of contracts of reinsurance on behalf of its principal and that collectively they amount to overwhelming evidence that such regulated activities are being carried out:
 - ◆ deciding what risks to refer to the offshore insurers or reinsurers;
 - ◆ advising insurers and reinsurers on premium rates;
 - ◆ making recommendations to the insurers or reinsurers as to the acceptance of a risk;
 - ◆ receiving notification of claims within agreed guidelines;
 - ◆ instructing loss adjusters; or
 - ◆ directly settling claims below an agreed amount.
- Writing a single contract of insurance or reinsurance can lead to a breach of the general prohibition if it is done by way of business in the UK.¹¹

In addition to effecting or carrying out contracts of insurance or reinsurance as principal in the UK, the following activities set out in the EU Insurance Mediation Directive (IMD) are also regulated by the FSA. Although the IMD is intended to apply to insurance and reinsurance intermediaries, unlike other EEA jurisdictions, insurers and reinsurers in the UK must also be authorised in respect of the following regulated activities if any of them are being conducted:¹²

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- arranging deals in contracts of insurance or reinsurance, where the arrangements bring about the deal to which the arrangements relate. This includes negotiation of the terms of a contract and the insurer or reinsurer entering into a contract as principal;
- making arrangements with a view to contracts of insurance or reinsurance being entered into. In this case, arranging will be regulated even if no contract is concluded; or
- advising a potential policyholder on contracts of insurance or reinsurance, where the advice relates to a particular contract and the merits of that person buying, selling, subscribing for or underwriting the contract.

EEA Insurers and Reinsurers in the UK

As noted above, EEA headquartered insurers and reinsurers can utilise passporting rights to enable them to carry on business in the UK on the basis of their home state licence without the need for additional authorisation by the FSA unless they are carrying on activities in the UK for which they are not authorised in their home state. If such activities are being carried on, an insurer can apply to the FSA for "top-up permission."

Non EEA Insurers and Reinsurers in the UK

Both insurance and reinsurance are regulated in the UK, and so any non-EEA insurer or reinsurer carrying on any of the regulated activities set out above in the UK will require FSA authorisation. This can be achieved by the establishment of a subsidiary or a branch of the non-EEA entity in the UK, which then applies for FSA authorisation. In order to avoid the requirement to be authorised in the UK, any activity that is regulated in the UK must be carried on wholly offshore.

Non-EEA insurers and reinsurers with a branch in the UK authorised by the FSA do not have the right to passport into other EEA jurisdictions and must conduct business in the relevant jurisdiction in accordance with host state rules. However, a subsidiary of a non-EEA insurer or reinsurer which is authorised by the FSA may take advantage of passporting rights to operate throughout the EEA.

Conclusion

In summary, non-EEA insurers (subject to any exemptions available in the relevant jurisdiction for MAT Insurance under GATS) and reinsurers may only operate within the EEA in the following ways:

- establishment of a subsidiary with authorisation in an EEA Member State
- establishment of an authorised branch of the non-EEA insurer or reinsurer in an EEA Member State (although passporting rights will not be available)
- provision of insurance or reinsurance into an EEA Member State (without actually carrying on regulated insurance or reinsurance business in the State), but only where permitted by the rules of the State. Most EEA Member States restrict the provision of insurance by non-EEA insurers at least to some extent. In the UK, for example, compulsory insurance classes, such as employers' and motor liability, must be provided by EEA insurers.

The Reinsurance Directive authorises the EU Commission to negotiate mutual recognition treaties in relation to reinsurance between the EU and third countries.¹³ Negotiation of such treaties may eventually make it easier for non-EEA (re)insurers to do business in the European market. At present the EU has treaties only with Norway, Iceland and Liechtenstein (which provide full mutual recognition) and Switzerland (which provides only for rights of establishment for insurers, subject to host state authorisation). Switzerland and Bermuda are known to be enthusiastic to negotiate treaties, but the U.S. position is bound up with the state-based regulatory system, which makes mutual recognition unlikely in the short to medium term.

Endnotes

1. EAA Member States include all member states of the European Union plus Norway, Iceland and Liechtenstein. EU member states are Austria, Belgium, Bulgaria, Cyprus, Czech Republic, Denmark, Estonia, Finland, France, Germany, Greece, Ireland, Hungary, Italy, Latvia, Lithuania, Luxembourg, Malta, Netherlands, Poland, Portugal, Romania, Slovak Republic, Slovenia, Spain, Sweden and the UK. Switzerland is not a member of the EEA.
2. The commitments of the EC and its Member States in relation to insurance are found in the "Understanding on Commitments in Financial Services."
3. Directives 73/239/EEC, 88/357/EEC, 92/49/EEC
4. Article 49 of the Directive
5. Section 19 FSMA
6. Section 23 FSMA
7. Regulation 10 and Schedule 1 of The Financial Services and Markets Act 2000 (Regulated Activities) Order 2001
8. *Stewart v Oriental Fire and Marine Insurance Co Ltd* [1985] 1 QB 988.
9. *DR Insurance Co v Seguros America Banamex* [1993] 1 Lloyd's Rep 120
10. *Secretary of State for Trade and Industry v Great Western Assurance Co SA* [1999] 1 Lloyd's Rep 377
11. *Bedford Insurance Company Ltd v Instituto de Resseguros Do Brasil* [1985] 1 QB 966.
12. Articles 25 and 53 of the Financial Services and Markets Act 2000 (Regulated Activities) Order 2001.
13. Paragraphs 30 and 31, Preamble to Directive and Article 50 of the Directive.