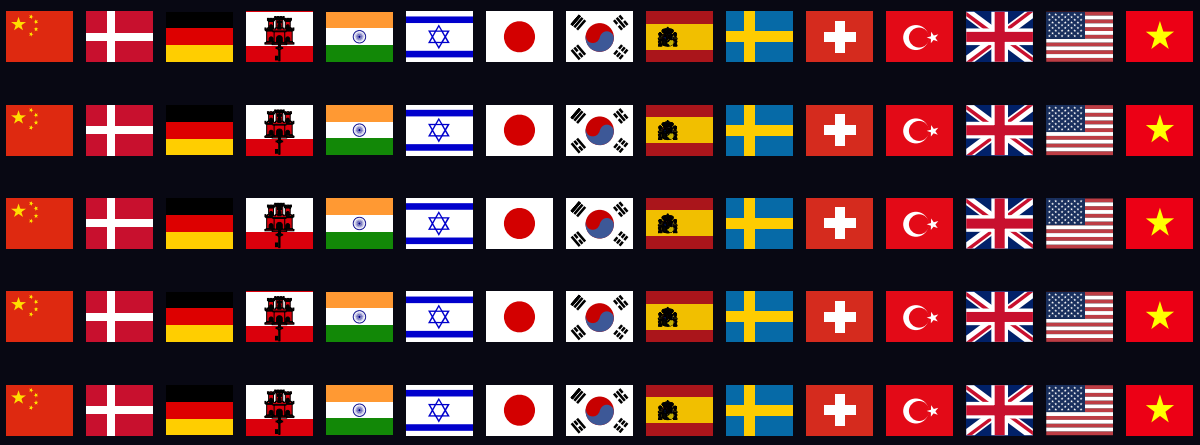
INSURANCE & REINSURANCE

United Kingdom



LEXOLOGY
Getting The Deal Through

Consulting editor
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Insurance & Reinsurance

Consulting editors

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Sullivan & Cromwell LLP

Quick reference guide enabling side-by-side comparison of local insights into insurance and reinsurance issues worldwide, including regulation of insurance and companies and their activities; insurance claims and coverage; reinsurance principles and practices; disputes (including arbitration); and recent trends.

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REGULATION

Regulatory agencies

Identify the regulatory agencies responsible for regulating insurance and reinsurance companies.

Under the Financial Services and Markets Act 2000 (as amended) (FSMA 2000), insurance and reinsurance companies in the United Kingdom are regulated by both the Prudential Regulation Authority (PRA) and the Financial Conduct Authority (FCA), which are responsible, respectively, for prudential regulation and conduct supervision of authorised firms. The PRA and the FCA are under a statutory duty to cooperate and coordinate those activities. (Re)insurers are referred to as dual regulated firms – they are regulated by the PRA and FCA. Insurance intermediaries, such as brokers, are regulated by the FCA only. Lloyd's of London (or the Society of Lloyd's) is regulated by the PRA and the FCA. While Lloyd's itself is not a statutory regulatory agency in the same sense as the PRA and FCA, it oversees and regulates the operation of the Lloyd's market and those operating within it. Lloyd's members underwrite through syndicates that are managed by Lloyd's managing agents. Lloyd's managing agents are dual regulated firms, in addition to being regulated and supervised by Lloyd's. Members' agents and Lloyd's brokers are regulated by the FCA as well as Lloyd's. The Bank of England and Financial Services Act 2016 made the PRA a part of the Bank of England.

Law stated - 29 March 2023

Formation and licensing

What are the requirements for formation and licensing of new insurance and reinsurance companies?

A firm intending to conduct (re)insurance business in the United Kingdom must obtain a Part 4A FSMA 2000 permission (Part 4A permission) from the PRA unless it is exempt (eg, appointed representatives and persons exempt as a result of an exemption order) or was able to rely on the EU's passporting regime. This passporting regime, however, ended on 31 December 2020 as far as the United Kingdom is concerned, when the Brexit transition period ended. In connection with the United Kingdom's exit from the European Union (Brexit), the PRA and the FCA implemented a 'temporary permissions regime', which permits non-UK European Economic Area (EEA) firms to continue to passport their services into the United Kingdom for a limited period following the end of the transition period. However, such firms will need to separately apply for a Part 4A permission as a third-country branch and are also subject now to some of the third-country branch rules.

The FCA must consent to the PRA's grant of permissions for new (re)insurance companies. To obtain a Part 4A permission, an applicant must be able to satisfy the 'threshold conditions' on an ongoing basis. These conditions include:

- demonstrating that a firm's head office is in the United Kingdom or that it carries on business in the United Kingdom;
- it is adequately capitalised to conduct the (re)insurance business in question; and
- it has appropriate management systems and controls in place, as well as suitably qualified and fit and proper persons capable of performing the relevant 'controlled functions'.

Law stated - 29 March 2023

Other licences, authorisations and qualifications

What licences, authorisations or qualifications are required for insurance and reinsurance companies to conduct business?

Unless an exemption applies, prior regulatory approval must be obtained to carry on 'regulated activities' by way of business in the United Kingdom. 'Regulated activities' are defined in the Financial Services and Markets Act (Regulated Activities) Order 2001 (as amended) and include effecting and carrying out (re)insurance contracts. Insurance mediation activities (ie, broking, distribution and other intermediary services) are regarded as separate regulated activities. Insurance intermediaries (who are not also (re)insurers) must apply to the FCA for permission to carry on intermediary activities in the United Kingdom. The relevant regulator (the PRA, the FCA, or both, as applicable) must approve each regulated activity individually. The regulator has the power to impose restrictions on the scope of a (re)insurer's regulated activities.

Directive (EU) 2016/97 (Insurance Distribution Directive) (IDD) (implemented into UK law through FSMA 2000, associated statutory instruments and the FCA Handbook) governs the authorisation, passporting and general regulatory requirements for (re)insurance intermediaries or distributors. It also encompasses organisational and business requirements for (re)insurance undertakings.

Law stated - 29 March 2023

Officers and directors

What are the minimum qualification requirements for officers and directors of insurance and reinsurance companies?

Officers, directors and persons who exercise senior management functions or 'controlled functions' under FSMA 2000 (eg, the director function, chief executive function, actuary function, or systems and controls function) must be approved by the PRA or FCA, or both, as applicable, before performing such functions. Such individuals must be 'fit and proper' to perform these roles, which essentially means that they should be trustworthy individuals with the relevant experience or qualifications to perform their particular role.

Once approved to perform such functions, the person in question becomes subject to the Senior Managers and Certification Regime (SM&CR) and accompanying conduct rules that impose several significant responsibilities, including a duty to comply with applicable regulatory requirements, general principles and expectations on an ongoing basis. The SM&CR was extended to cover all PRA and FCA regulated (re)insurance firms on 10 December 2018. The SM&CR was further extended to cover all PRA and FCA regulated firms with effect from 9 December 2019 (subject to a transition period ending on 31 March 2021 for FCA solo-regulated firms). The primary objective of the SM&CR is to heighten individual accountability and ensure policyholder protection.

Individuals performing a designated Senior Management Function will need to be pre-approved by the relevant regulator before being appointed to their role and will be subject to annual fit and proper assessments by their firm. Individuals who are not senior managers but whose job can potentially cause significant harm to the firm or its customers will be certified annually by their firm to check that they are suitable to do their job. Further enhanced requirements apply to the largest and most complex firms, including having in place a management responsibilities map and handover procedures for all senior manager roles.

Law stated - 29 March 2023

Capital and surplus requirements

What are the capital and surplus requirements for insurance and reinsurance companies?

UK capital requirements adopted, but also enhanced, the requirements established originally by the EU Insurance Directives. Capital requirements were then embodied in Directive 2009/138/EC (Solvency II) and are contained in the PRA Handbook with further details in the Commission Delegated Regulation (EU) 2015/35 (the Solvency II Delegated Act) . Slightly different requirements apply to general and life insurers and pure reinsurers, with an overarching reserve power of the PRA to impose additional capital requirements (individual capital add-ons) if deemed necessary. Pillar 1 of Solvency II introduced new quantitative capital requirements at both the solo entity and at the group level. With the approval of the regulator, companies and particularly groups can develop their own internal risk-based capital models according to their economic capital needs relative to their risk profile. Pillar 1 capital requirements have two distinct levels:

- a minimum capital requirement representing the minimum amount of capital that a (re)insurer needs to cover its risks (which goes beyond just underwriting risks); and
- a solvency capital requirement (SCR), which is effectively the amount of capital a (re)insurer requires to operate as a going concern, assessed on a value at risk measure over a period of one year.

As part of its interim review of the Solvency II Delegated Act in 2018, the European Commission reviewed the methods, assumptions and standard parameters used when calculating solvency capital requirements. However, certain issues, including interest-rate risk, were specifically deferred to the comprehensive review of Solvency II, which the European Commission was required to carry out before the end of 2020. Owing to the covid-19 pandemic, this review was delayed and the European Insurance and Occupational Pensions Authority (EIOPA) provided the European Commission with its Opinion in December 2020. This Opinion contained several recommendations on areas including long-term guarantee measures, solvency capital requirements and the risk margin (among others). On 22 September 2021, the European Commission published legislative proposals for amendments to Solvency II and conducted a stakeholder review of these proposals until January 2022. The proposals included changes to:

- the proportionality principle;
- ORSA and investment decisions;
- climate change; and
- groups.

The Council agreed its position on the proposal in June 2022 and must now agree a final version of the text with the European Parliament. The current expectation is that the amendments will come into force in 2023 or 2024 with a further 18 months for the rules to be transposed into the national law of each member state.

The Solvency II Delegated Act and other EU rules were incorporated into UK law when the transition period for the United Kingdom leaving the European Union ended on 31 December 2020, and these provisions, therefore, continue to apply in the United Kingdom. HM Treasury initiated a review of the UK's Solvency II regime in 2020 and issued a consultation paper in April 2022, followed by a second consultation paper in November 2022 setting out the future reform package. Key areas of reform include:

- reducing the risk margin significantly;
- maintaining the existing methodology and calibration of the fundamental spread, while increasing the risk sensitivity;

- increasing investment flexibility, in particular broadening the matching adjustment eligibility criteria to include assets with highly predictable cashflows; and
- removing branch capital requirements for foreign firms with appropriately capitalised parent companies.

Law stated - 29 March 2023

Reserves

What are the requirements with respect to reserves maintained by insurance and reinsurance companies?

Solvency II (adopted into the PRA Rulebook) introduced material changes to reserving and the calculation of reserves, or 'technical provisions'. Articles 76–80 of Solvency II set out the basic requirements as to establishment and possession of technical provisions and as to their calculation. These are supplemented by the Solvency II Delegated Act, which, post Brexit, has been incorporated into UK law as 'retained EU law'. Unsurprisingly, (re)insurers are required to establish technical provisions concerning all their (re)insurance obligations towards policyholders, and to calculate those provisions in a prudent, reliable and objective manner. A major challenge introduced in the reserving process by Solvency II, however, is that the technical provisions must not only represent a best estimate of the liabilities but also include a 'risk margin' to cover the cost of capital as prescribed. Also, when calculating technical provisions, (re)insurers must segment their (re)insurance obligations into homogenous risk groups and by lines of business as prescribed, hence raising specific allocation issues. The value of the technical provisions must correspond to the current amount the (re)insurer would have to pay if it were to transfer its (re)insurance obligations immediately to another (Solvency II-regulated) (re)insurer. A reduction in the risk margin is part of the UK's ongoing review of the UK's Solvency II regime and the PRA's proposals are expected to be published for consultation in June 2023.

Law stated - 29 March 2023

Product regulation

What are the regulatory requirements with respect to insurance products offered for sale? Are some products regulated by multiple agencies?

No prior regulatory approval or registration of insurance products is required in the United Kingdom. Instead, the FCA, in the exercise of its statutory objective of consumer protection and its 'outcomes-focused' approach to regulatory supervision, imposes on insurers requirements as to their conduct of business and as to the suitability of insurance products sold to consumers, and regulates the selling and administration of insurance contracts, providing detailed rules including on categorisation of customers, communications with and financial promotions to customers, conflicts of interest, record-keeping, disclosures required to be made to customers, and product information. Insurers must also comply with the FCA's General Principles for Business and in this context insurers (particularly those selling retail products) must be mindful of the need to 'pay due regard to the interests of customers and treat them fairly' and 'to the information needs of clients and communicate information to them in a way that is clear, fair and not misleading'. The FCA has statutory powers of product intervention that would allow it to restrict the use of certain insurance product features, require that a product not be marketed or sold to certain categories of customer, or even ban the marketing or sale of a product.

Recent changes to consumer protection laws in the United Kingdom (eg, the Consumer Insurance (Disclosure and Representations) Act 2012 , the Consumer Rights Act 2015 and the Insurance Act 2015) provide enhanced protection for consumers buying insurance products and regulate the permitted content of policies, including concerning the use of unfair contract terms, a prohibition on insurers asking consumers to contract out of statutory rights and, in the case

of non-life insurance, specific disclosures of product information that has to be provided to the buyer before the insurance contract is formed.

The FCA introduced new rules in July 2022 in relation to a new Consumer Principle of Business whereby 'a firm must act to deliver good outcomes for retail customers'.

Law stated - 29 March 2023

Regulatory examinations

What are the frequency, types and scope of financial, market conduct or other periodic examinations of insurance and reinsurance companies?

US-style examinations of (re)insurers do not occur in the United Kingdom, and there is no public hearing process provided for in the usual conduct of regulatory affairs by the FCA or the PRA. Instead, the UK regulatory approach is to provide regulatory oversight through a combination of reporting, self-reporting, regulatory visits (the frequency of which depends on the size and type of (re)insurer) and regulatory intervention, if required. Regulatory oversight is exercised by the FCA (as to conduct) and the PRA (as to prudential matters) working together under a memorandum of understanding between those regulators. Underpinning the oversight function are the duties imposed on (re)insurers under the FCA's Principles for Businesses and the PRA's Fundamental Rules.

Both the FCA and the PRA conduct visits and in-person interviews with (re)insurers regularly and also perform regular market studies or reviews of a particular aspect of UK (re)insurers businesses. Governance and reserving are examples of recent industry reviews by the PRA.

Law stated - 29 March 2023

Investments

What are the rules on the kinds and amounts of investments that insurance and reinsurance companies may make?

Insurers are required to hold assets to cover their technical provisions and to maintain an adequate available amount of capital on top of the technical provisions. Solvency II has introduced a less prescriptive regime as to the nature and identity of eligible assets to cover the technical provisions and capital requirements, introducing instead the 'prudent investor' concept. Most of the previous restrictions as to asset admissibility, percentage holding of assets and counterparty exposure limits have been removed, giving insurers greater freedom to invest in assets that are appropriate to their business and their individual solvency capital requirement. The prudent-investor concept essentially requires insurers to invest in assets that match their liabilities in terms of duration and liquidity and are of sufficient quality to ensure they will be available when needed. Investments in unlisted securities and alternative riskier assets should be kept to a minimum, and capital requirements for market risk have been introduced on the asset side of the balance sheet. Hence, insurers may invest in riskier assets but will need to hold capital against the risk of these assets falling in value, whether due to equity risk, spread risk, interest-rate risk, concentration risk, counterparty or credit risk. Relevant stress tests for the different types of market risk are set out in the Solvency II Delegated Act.

Increasing flexibility for (re)insurers to invest in long-term assets forms part of HM Treasury's final reform package in connection with the UK's Solvency II review.

Law stated - 29 March 2023

Change of control

What are the regulatory requirements on a change of control of insurance and reinsurance companies? Are officers, directors and controlling persons of the acquirer subject to background investigations?

Under Part XII of FSMA 2000, a person must not acquire or increase control in a UK-regulated (re)insurance company without the prior approval of the PRA (it is a criminal offence to do so without such prior approval). 'Control' is defined as the acquisition of 10 per cent or more of the shares or voting power of the regulated entity or its parent entity with an overarching (and ill-defined) concept of the ability to exercise significant influence over the management of the regulated entity by virtue of any amount of shareholding or voting power in the regulated entity or its parent. Prior regulatory approval will also be required where an existing controller proposes to increase its shareholding or entitlement to exercise voting power in the (re)insurer or its parent to 20, 30 or 50 per cent or more. The PRA must consult with the FCA, and the FCA may request the PRA to reject the application or impose conditions on the approval of the change in control.

Applications for a change in control in respect of insurance intermediaries are made to the FCA, but the same general rules apply.

Directors and officers of the proposed acquirer will be subject to questions as to their suitability (reputation, integrity and employment history in the regulated sector if relevant). Some may wish to be appointed to the board or to become senior managers of the regulated entity, in which case they will need to apply for approval to exercise senior management functions in the regulated target entity, and will be subject to background investigations.

Law stated - 29 March 2023

Financing of an acquisition

What are the requirements and restrictions regarding financing of the acquisition of an insurance or reinsurance company?

There are no specific requirements or restrictions in respect of the financing of the acquisition of a (re)insurance company. Where the acquirer is itself a (re)insurance company, any debt or equity raised to fund the acquisition may affect the acquirer's own regulatory capital position and overall availability of resources and so may need prior disclosure to and consent from regulators. It will also need to be considered whether any acquisition financing or debt push down to the target(s) would either come within the financial assistance regime under Part 18, Chapter 2 of the Companies Act 2006, or would otherwise impact the regulatory capital position of the acquirer or the target. It may also affect the group solvency position post-acquisition. There are no specific UK rules mandating or prohibiting any particular acquisition financing method but the PRA will look at acquisition financing when considering a change of control application. Also, dividends are not restricted generally from insurance companies to their parents to pay interest amounts, subject to meeting regulatory capital requirements. However, the PRA should be notified of, and can challenge, dividends that may materially change the capital position of the paying insurance company or insurance group.

Law stated - 29 March 2023

Minority interest

What are the regulatory requirements and restrictions on investors acquiring a minority interest in an insurance or reinsurance company?

At less than 10 per cent of voting rights or share ownership, there should be no restrictions unless the acquirer of the minority interest can exercise significant influence over the management of the insurer or reinsurer, which could trigger a requirement for change in control approval.

Law stated - 29 March 2023

Foreign ownership

What are the regulatory requirements and restrictions concerning the investment in an insurance or reinsurance company by foreign citizens, companies or governments?

There are no specific restrictions or prohibitions on investment in a (re)insurance company by foreign citizens, companies or governments, although the National Security and Investment Act 2021, which came into force in January 2022, introduced changes to the United Kingdom's foreign investment regime, including a requirement for mandatory notifications of mergers and acquisitions in sensitive sectors, which may apply to certain insurance transactions.

Law stated - 29 March 2023

Group supervision and capital requirements

What is the supervisory framework for groups of companies containing an insurer or reinsurer in a holding company system? What are the enterprise risk assessment and reporting requirements for an insurer or reinsurer and its holding company? What holding company or group capital requirements exist in addition to individual legal entity capital requirements for insurers and reinsurers?

Solvency II introduced new provisions concerning group supervision and brought the entire group within the Solvency II framework, requiring groups subject to Solvency II to comply with Solvency II requirements under each of the three Pillars (quantitative, supervisory and disclosure) at both the level of the authorised (re)insurance entities and on a group-wide basis. Groups have to establish an own-risk and solvency assessment process for the group as a whole, as well as adequate and consistent risk management and governance procedures throughout the group, and satisfy regulatory supervisors as to the adequacy of these measures. Groups will also have to comply with all Pillar 3 regulatory and public disclosure requirements for groups.

The group supervisor under Solvency II will usually be the supervisor in the country where the ultimate parent of the group has its headquarters, but groups may be supervised at more than one level and may have more than one group or individual supervisor, working as a college. Reporting and disclosure under Solvency II are required at the group and solo-entity level, although a group may apply for approval to report as a single combined entity.

Primary disclosures are made through annual solvency and financial condition reports (SFCR), as well as through public disclosure of the group SCR. In addition to the annual SFCR, a regular supervisory report will need to be submitted on an annual basis (but need not be publicly disclosed), and quantitative reporting templates will need to be submitted on both a quarterly and an annual basis.

Group solvency, which includes the holding company and all subsidiaries, must be calculated at least annually. The group SCR covers the capital requirements of all the entities in the group calculated on a consolidated balance sheet.

Group solvency must be calculated under the accounting consolidation method as the default method, or the deduction and aggregation method or a combination of both methods with supervisory approval. All group solvency calculations are to be carried out at the ultimate parent insurance entity or insurance holding company level. In the context of global groups, where subgroups exist at the EU level, supervisory authorities may decide to apply the group solvency calculation at the EU sub-group level only as to which entities form part of the group, amendments to the inclusion of non-insurance subsidiaries (which are regulated by other financial sectors) in the group solvency calculation and the introduction of more detailed governance requirements.

The United Kingdom officially left the European Union on 31 January 2020, subject to a transition period that ended on 31 December 2020. A Treasury Select Committee was established in September 2016 to look into EU insurance regulation and its effect in the UK. The Chair of the Treasury Committee said: 'The Treasury Committee will now take a look at the Brexit inheritance on insurance to see what improvements can be made in the interests of the consumer.' Discussions are currently ongoing nationally and with the EU Commission about the 'equivalence' post-Brexit status of the United Kingdom in terms of the requirements of Solvency II. The UK has granted a package of equivalence decisions to the EU and EEA member states including for the three equivalence areas under Solvency II; reinsurance, group solvency calculation and group supervision. However, as yet, the EU Commission has not reciprocated so the UK has not been granted equivalence under Solvency II. The UK and the EU committed to agreeing a Memorandum of Understanding (MoU) on a framework for cooperation between financial regulators by March 2021. The MoU is intended to facilitate discussions between the UK and the EU on how to move forward with equivalence determinations. Although the UK and EU confirmed that a text had been agreed in principle, no MoU has yet been formally agreed or published.

Law stated - 29 March 2023

Reinsurance agreements

What are the regulatory requirements with respect to reinsurance agreements between insurance and reinsurance companies domiciled in your jurisdiction?

The various rules attached to the content of consumer insurance contracts generally do not apply to reinsurance contracts, and there is no specific UK regulatory regime prescribing the content, scope or application of reinsurance contracts governed by English law. In the UK, reinsurance is generally regulated in the same way as primary insurance, and English law on insurance contracts generally applies likewise to reinsurance contracts.

The Insurance Act 2015 applies to non-consumer insurance contracts and also applies to reinsurance contracts. The Insurance Act 2015 abolished some of the draconian consequences of a breach of the duty of utmost good faith or breach of warranties in insurance contracts and instead laid down more proportionate remedies for such breaches, including premium adjustments for certain misrepresentations.

Law stated - 29 March 2023

Ceded reinsurance and retention of risk

What requirements and restrictions govern the amount of ceded reinsurance and retention of risk by insurers?

Cedents need to consider several factors when judging the size of any cession or retention, the starting point being the basic requirement that a cedent may take credit for reinsurance only if, and to the extent that, there has been an effective transfer of risk from the cedent to a third party. Solvency II and the PRA Rulebook provide detailed requirements as to what is required in terms of the counterparty and the reinsurance arrangements itself for credit to

be taken for the reinsurance. A reinsurer that is authorised as an insurance special purpose vehicle (ISPV) will have to fully fund its exposures to risks it assumes through the proceeds of a debt issuance or some other financing mechanism. Both cedent and reinsurer, if regulated in the United Kingdom, will also have to be mindful of the provisions in the PRA Rulebook regarding prudential requirements and risk assessment monitoring and control. While there is no specific rule limiting reinsurance to a certain percentage of the risk, most regulators in Europe prefer some risk retention to align interests, maintain some control and prevent overexposure to one counterparty. The generally accepted minimum retention is 10 per cent unless some other amount can be objectively justified. Also, taxation considerations, including UK-diverted profits taxes, need to be considered and may mandate a higher net retention.

Law stated - 29 March 2023

Collateral

What are the collateral requirements for reinsurers in a reinsurance transaction?

There are no prescribed requirements for collateral to be provided by reinsurers under English law or UK regulation. The ceding insurer and the reinsurer are at liberty to agree to whatever form of collateral (if, indeed, any) they choose. Insofar as reinsurance arrangements are collateralised to protect against counterparty risk, they can be structured under English law to qualify as 'financial collateral arrangements' under Directive 2002/47/EC (Financial Collateral Directive), which facilitates the enforcement of security over financial collateral within the European Union. Under Solvency II, EU member states are no longer able to impose on reinsurers from an 'equivalent' jurisdiction (or another EU member state) collateral requirements that require the pledging of assets to cover unearned premiums and outstanding claims provisions. However, if collateral is provided, it will need to satisfy the requirements for collateral set out in Solvency II to receive regulatory credit. Since the UK has not, as of the date of writing, been deemed equivalent by the European Union for Solvency II purposes, EEA insurers may require UK reinsurers to pledge assets to cover unearned premiums and outstanding claims provisions.

In 2017, the European Union and the United States announced that they had successfully concluded the negotiation of a bilateral agreement between the European Union and the United States on prudential measures regarding insurance and reinsurance (the Covered Agreement). The Covered Agreement addresses three areas of prudential insurance regulation important to internationally active (re)insurers:

- reinsurance;
- group supervision; and
- the exchange of information between insurance supervisors.

The key aspects of the Covered Agreement are intended to provide EU-based (re)insurers with relief from US collateral requirements, to provide US-based (re)insurers with relief from EU local-presence requirements, and to free US insurance groups operating in the European Union from EU worldwide group supervision, capital, solvency, reporting and governance requirements under Solvency II-applicable implementing legislation. Similarly, in 2018, the United States and the UK announced that they had also signed a bilateral agreement (the UK–US Covered Agreement), which addresses:

- the elimination of local presence requirements imposed by one party on an assuming reinsurer that is domiciled in the other party;
- the elimination of collateral requirements imposed by a party on an assuming reinsurer that is domiciled in the other party; and
- the role of the host and home supervisory authorities concerning prudential group supervision of a (re)insurance

group whose worldwide parent undertaking is in the home party.

Law stated - 29 March 2023

Credit for reinsurance

What are the regulatory requirements for cedents to obtain credit for reinsurance on their financial statements?

The extent to which a ceding insurance company can take credit for reinsurance, including by treating the reinsurer's share of technical provisions as an eligible asset of the ceding company or by reducing the ceding company's solvency requirements or valuing cash flows for reserves, will depend on whether and, if so, to the extent that the contract of reinsurance effectively transfers risk from the ceding company to the reinsurer. The Prudential Sourcebook for Insurers (INSPRU) 1.1.19 used to set out the basic risk transfer requirement for all reinsurance contracts (including those with an ISPV) and for analogous non-reinsurance financing agreements for which a ceding company might likewise wish to take credit (eg, contingent loans and securitisations) but is not included in the PRA Rulebook. The requirements of INSPRU 1.1.19 have become industry standards (also looked to by auditors and actuaries when considering the valuation of reinsurance coverage programmes) and so the current provisions of the PRA Rulebook on Technical Provisions on the valuation of recoverables from reinsurance contracts and ISPVs should be read with that in mind. Reference should also be made to the Solvency II Delegated Act, which sets out rules relating to technical provisions and the requirements for a reinsurance contract to be eligible as a risk mitigant under Solvency II.

Law stated - 29 March 2023

Insolvent and financially troubled companies

What laws govern insolvent or financially troubled insurance and reinsurance companies?

Under Part XXIV of FSMA 2000, the UK regulators (PRA and FCA) are given the right to be involved in insolvency proceedings against insurers. The insolvency proceedings available in the UK against insurers include liquidation, administration, a company voluntary arrangement and the appointment of a provisional liquidator. Insolvent insurance companies can also use a scheme of arrangement under Part XXVI of the Companies Act 2006. Relevant UK legislation includes:

- the Insurers (Reorganisation and Winding Up) Regulations 2004 (2004 Regulations);
- the Insolvency Act 1986;
- Part XXIV of FSMA 2000; and
- the Insurers (Winding Up) Rules 2001.

The 2004 Regulations set out a governing framework to determine issues arising in insurance insolvencies within the European Union, and provide for mutual recognition of member states' insurance insolvency and winding-up measures. The 2004 Regulations also establish the priority of payment of insurance and other claims in an insurance insolvency.

The Insolvency Act 1986 provides the basic law and framework for insolvency, administration and voluntary and involuntary liquidation in the UK and applies to insurers, as it applies to other corporate entities, in respect of procedures for the appointment of administrators and liquidators and the winding up of insurers by court order. The Insurers (Winding Up) Rules 2001 provide detailed rules as to the conduct of an insurance liquidation and the procedures to be followed by the liquidator, and for the separation of life or long-term business assets in a liquidation from other assets. Lloyd's has its own procedures in the event of a syndicate or member being in financial difficulties,

including a cash call on syndicate members to pay losses, the syndicate year of account being unable to close at 36 months and being left open in an effective run-off until closure is possible, and the liabilities being settled in whole or in part by (and at the discretion of) the Lloyd's Central Fund. The Risk Transformation Regulations 2017 provides for the introduction into UK law of the protected cell company (PCC) to accommodate the demand for a suitable vehicle for insurance-linked securities and alternative risk transfer, akin to structures that have been available in the Channel Islands, Bermuda and other offshore centres for some years. PCCs have their own procedure for dissolution and winding up under the Risk Transformation Regulations 2017.

Law stated - 29 March 2023

Claim priority in insolvency

What is the priority of claims (insurance and otherwise) against an insurance or reinsurance company in an insolvency proceeding?

The Insurers (Reorganisation and Winding-Up) Regulations 2004 provide, inter alia, that preferred creditors (being those with preferential debts, such as monies due to HMRC, social security and pension scheme contributions, and employee remuneration) will rank first in order of priority and that (subject to the claims of preferred creditors) direct insurance claims (eg, monies owed to an insurer's own policyholders) will have priority over the claims of all other unsecured creditors (except for preferred creditors), including reinsurance creditors, on a winding up by the court or a creditor's voluntary winding up of the insurance company. In the case of insurers carrying on both insurance and reinsurance business, sums due to direct policyholders are given priority over sums due to cedents. Instead of making a winding-up order, a UK court may, under section 377 of FSMA 2000, reduce the amount of one or more of the insurance company's contracts on terms and subject to conditions (if any) that the court considers fit. In the case of preferential debts and in the case of insurance debts, the debts of each class respectively rank equally among themselves and must be paid in full or, if assets are insufficient to meet them, the debts are abated in equal proportions. For a composite insurer authorised to carry on both life and non-life business, the life and non-life debts must be determined separately, and life claims settled from only the life assets and non-life claims settled only from non-life assets.

Law stated - 29 March 2023

Intermediaries

What are the licensing requirements for intermediaries representing insurance and reinsurance companies?

The IDD applies to and requires authorisation both of independent intermediaries (eg, insurance brokers) and of (re)insurers insofar as they conduct (re)insurance mediation activities. All those intermediaries involved in selling and underwriting a (re)insurance contract will require a licence unless they can benefit from an exemption. Third-party administrators will not necessarily require a licence depending on the specific activities they perform. Claims-management companies are subject to licensing by the FCA.

The IDD also provides for 'passporting' by intermediaries covered by that directive throughout the European Union and for organisational and business requirements. The regulatory requirements applicable to intermediaries mirror, to a considerable extent, many of the requirements applicable to (re)insurers, including principles for business and conduct of business, and the approved-persons regime. The IDD also enables intermediaries to operate throughout the European Union using freedom of services or establishment. Some Brexit passporting under the IDD no longer applies in the UK.

Insurance intermediaries in the UK require authorisation from the FCA primarily, but if the intermediary is part of a

group that includes a firm authorised by the PRA, then the FCA will also have to consult with the PRA before granting any Part 4A FSMA 2000 permission for insurance mediation. The IDD includes several exclusions and exemptions from the need for intermediaries to be authorised and the UK retains the system whereby an intermediary can itself be an 'appointed representative' of another authorised person and thereby obviate the need for individual authorisation of the intermediary, although all intermediaries, including appointed representatives, must be registered on the Financial Services Register.

Law stated - 29 March 2023

INSURANCE CLAIMS AND COVERAGE

Third-party actions

Can a third party bring a direct action against an insurer for coverage?

Under the Third Parties (Rights Against Insurers) Act 1930 and the Third Parties (Rights Against Insurers) Act 2010, as amended by the Insurance Act 2015, a third party with a claim against an insured can bring proceedings against the insurer in the event of the insured's insolvency. It is not possible to contract out of this. The rights transferred to the third party are the rights of the insured against the insurer under the contract of insurance in respect of the liability in question. Rights that are not referable to that liability are not transferred. The above-mentioned third-party actions do not apply to reinsurance contracts.

Law stated - 29 March 2023

Late notice of claim

Can an insurer deny coverage based on late notice of claim without demonstrating prejudice?

In commercial policies, there is usually an express requirement to notify the insurer within a given number of days of the claim arising. The consequences of late notice will depend on whether the notice requirement is a condition precedent to the insurer's liability. If so, the insurer will be able to avoid paying the claim even if the delay in notifying the claim did not prejudice the insurer's position. In Taylor v Builders Accident Assurance Ltd [1997] PIQR, it was held that the delay in notifying the claim to the insurer deprived the insurer of its right to investigate and defend the claim, thus amounting to a repudiatory breach, even though the condition breached was not expressly stated as a condition precedent. The court will look at the facts in each case and consider each policy on a case-by-case basis.

Law stated - 29 March 2023

Wrongful denial of claim

Is an insurer subject to extra-contractual exposure for wrongful denial of a claim?

As a general principle, English law does not provide a remedy in damages for the insured in the event of a wrongful denial of claim by the insurer. The burden of proof will be on the insured.

Law stated - 29 March 2023

Defence of claim

What triggers a liability insurer's duty to defend a claim?

The notification by the insured of an event or circumstance within the terms of the policy for which the insurer may be liable triggers the insurer's duty to defend a claim.

Law stated - 29 March 2023

Indemnity policies

For indemnity policies, what triggers the insurer's payment obligations?

To succeed in a claim on an indemnity policy, the insured must demonstrate to the insurer that the insured is under a legal liability to one or more of those claiming against the insured and that the loss in question is covered by the policy (Peninsular & Oriental Steam Navigation Co v Youell [1997] 2 Lloyd's Rep 136, CA).

Law stated - 29 March 2023

Incontestability

Is there a period beyond which a life insurer cannot contest coverage based on misrepresentation in the application?

Subject to any provision to the contrary in the terms of the policy, there is no general incontestability period beyond which a life insurer cannot contest coverage based on misrepresentation in the application for coverage.

Law stated - 29 March 2023

Punitive damages

Are punitive damages insurable?

Subject to the terms of the insurance policy, as a matter of general principle and public policy, damages awarded by a court, whether ordinary or punitive, are insurable.

Law stated - 29 March 2023

Excess insurer obligations

What is the obligation of an excess insurer to 'drop down and defend', and pay a claim, if the primary insurer is insolvent or its coverage is otherwise unavailable without full exhaustion of primary limits?

Subject to a contractual provision to the contrary, an excess insurer will not be under a duty to 'drop down and defend' or pay the claim unless the primary insurer's limit of cover is fully exhausted.

Law stated - 29 March 2023

Self-insurance default

What is an insurer's obligation if the policy provides that the insured has a self-insured retention or deductible and is insolvent and unable to pay it?

In Teal Assurance Co Ltd v (1) WR Berkley Insurance (Europe) Ltd ; (2) Aspen Insurance UK [2013] UKSC 37, the

Supreme Court held that a requirement in a policy for the insured to have 'paid' the amount of the self-insured retention or deductible before the insurer indemnifying the insured under the terms of the policy did not mean that the insured had to have made a monetary payment. Instead, the word 'paid' should be understood as being used as a measure of liability incurred.

Law stated - 29 March 2023

Claim priority

What is the order of priority for payment when there are multiple claims under the same policy?

There is no particular order of priority for the payment of claims in circumstances where multiple claims are presented under the same policy. Each case will depend upon the exact wording of the policy.

The court will look at the reality and facts of each case (see Mabey and Johnson Ltd v Ecclesiastical Insurance Office plc [2004] Lloyd's Rep IR 10 as per Morrison J).

Claims are usually paid in chronological order once they have been fully proved.

Law stated - 29 March 2023

Allocation of payment

How are payments allocated among multiple policies triggered by the same claim?

As a starting point, the insured may not recover more than the loss sustained. The insured may choose, subject to the terms of the policy, which policy it wishes to claim under. The insurer who covers the loss may then be able to seek a contribution from the other insurer under the equitable doctrine of contribution (Boag v Economic Insurance Company Ltd [1954] 2 Lloyd's Rep 581). The obligation to contribute applies even though a co-insurer's policy may be narrower or broader in its coverage provided that:

- the coinsurer's policy is in force and has not been repudiated (eg, due to a breach of the duty to disclose);
- the coinsurer's policy conveys the same risk as the policy under which the claim was paid;
- the same risk under both coinsurer's policies led to the loss;
- the insured had the same interest in the subject matter of each insurance policy; and
- the policies are effected by, on behalf of or provide benefit for, the same insured.

Law stated - 29 March 2023

Disgorgement or restitution

Are disgorgement or restitution claims insurable losses?

There is no statutory definition of 'insurable losses'. In Prudential Insurance Co v Commissioners of Inland Revenue [1904] 2 HB 658, it was held that to be insurable, the loss must have the following characteristics:

- there must be an element of uncertainty about whether, when and how the loss will occur;
- if it were to happen, the loss must have an adverse effect on the insured; and
- the insured must have an insurable interest in the subject matter of the loss.

Disgorgement is available only when the insured has breached an obligation of good faith or loyalty. Consequently, disgorgement is not an insurable loss. On the other hand, restitution claims are capable of being an insurable loss.

Law stated - 29 March 2023

Definition of occurrence

How do courts determine whether a single event resulting in multiple injuries or claims constitutes more than one occurrence under an insurance policy?

The terms 'occurrence' and 'event' are often not precisely defined in insurance contracts. In Kelly v Norwich Union Fire Insurance Society [1989] 2 All ER 888, the Court of Appeal held that the word 'event' referred to the peril rather than the damage in respect of various claims that had been made.

In AXA Reinsurance UK Ltd v Field [1996] 1 WLR 1026, the House of Lords defined an 'event' or an 'occurrence' as something that happens at a particular time, and in a particular place and way. In Mitsubishi Electric v UK Ltd Royal London Insurance (UK) Ltd [1994] 2 Lloyd's Rep 249, the court aggregated several separate losses as one loss, holding that all the losses arose from the same occurrence. In Lloyds TSB General Insurance Holdings LTD v Lloyds Bank Group Insurance Co Ltd [2003] Lloyd's Rep IR 623, the House of Lords emphasised that each case must depend upon the exact wording of the relevant 'occurrence' clause. Further, it stressed that in clauses of this kind it is essential to focus on the question of the causes of the various losses.

In AIOI Nissay Dowa Insurance Company Limited v Heraldglen Limited and Advent Capital (No. 3) Ltd [2013] EWHC 154, a case that considered the definition of 'event' or 'occurrence' in the context of the terrorist attacks of 11 September 2001 on the twin towers of the World Trade Center in New York, Field J held that the 'four unities' of the circumstances and purposes of the persons responsible, cause, timing and location of the 'event' or 'occurrence' represented a useful test for establishing whether there was one or more 'event' or 'occurrence'. In AIG Europe Ltd v OC320301 [2016] EWCA Cir 367, the Court of Appeal had to determine the true construction of the phrase 'a series of related transactions' in the aggregation clause in the standard minimum terms and conditions of solicitors' compulsory liability insurance. The Court of Appeal held that the first instance judge had misdirected himself in saying that the transactions had to be 'dependent' on each other before aggregation could occur. Instead, the connection between the matters or transactions had to be an intrinsic relationship rather than an extrinsic one with a third factor.

Law stated - 29 March 2023

Rescission based on misstatements

Under what circumstances can misstatements in the application be the basis for rescission?

The Insurance Act 2015 abolished 'basis of contract' clauses in insurance contracts. Such clauses have the effect of elevating the insured's answers to an insurer's questions to the status of contractual warranties. If the insured's answers are, in fact, material misstatements, the insurer may rescind the contract. A misstatement is material if it would influence the judgment of a prudent insurer in pricing the premium or deciding whether to take the risk. The Insurance Act 2015 imposes a duty of fair representation on the insured. Where the breach of this duty is deliberate or reckless, the insurer may avoid the contract, refuse all claims and need not return any of the premiums paid. Where the breach was neither deliberate nor reckless, the insurer may avoid the contract and refuse to pay all claims but must return the premiums paid.

Law stated - 29 March 2023

REINSURANCE DISPUTES AND ARBITRATION

Reinsurance disputes

Are formal reinsurance disputes common, or do insurers and reinsurers tend to prefer business solutions for their disputes without formal proceedings?

There are no special procedures for reinsurance disputes under English law. Most reinsurance contracts contain an arbitration or choice of forum clause. Where the English courts have exclusive jurisdiction, disputes are likely to be referred to the Commercial Court, which has experience in dealing with reinsurance disputes. If a reinsurance contract contains an arbitration clause, disputes arising from that contract may be resolved by an arbitral tribunal. Parties to a reinsurance contract may also choose to reach a settlement before initiating formal proceedings. Indeed, the Pre-Action Protocols under the Civil Procedure Rules require that attempts to settle out of court be made before litigation is commenced.

Law stated - 29 March 2023

Common dispute issues

What are the most common issues that arise in reinsurance disputes?

As a general rule, reinsurance disputes tend to be resolved before the commencement of a formal dispute process. However, to the extent such process is engaged, the issue of aggregation of claims, whether in connection with the approach to 'event' and 'occurrence' under a typical excess of loss catastrophe bond treaty or aggregation over a specified period often arises as a significant issue between parties. Jurisdiction disputes also arise in reinsurance disputes (see Faraday Reinsurance Co Ltd v Howden North America Inc & Another [2012] EWCA Civ 980). Follow-the-fortunes and cut-through clauses are also often disputed.

Law stated - 29 March 2023

Arbitration awards

Do reinsurance arbitration awards typically include the reasoning for the decision?

It is a well-established principle of English law that arbitral tribunals must give reasons for their decision. Arbitrations that have their seat in England and Wales are governed by the Arbitration Act 1996 (AA 1996). If the parties do not agree on the form of an award, then section 52(4) of AA 1996 requires that an award 'shall contain the reasons for the award unless it is an agreed award or the parties have agreed to dispense with reasons'. The International Chamber of Commerce and the London Court of International Arbitration are commonly used arbitral institutions with their own independent rules to govern the proceedings, which include provisions with respect to reasoned arbitral awards.

Law stated - 29 March 2023

Power of arbitrators

What powers do reinsurance arbitrators have over non-parties to the arbitration agreement?

Non-signatories to a contract may, in certain circumstances, claim the benefits of that contract as third-party beneficiaries under the Contracts (Rights of Third Parties) Act 1999 (C(RTP)A 1999). In such circumstances, the third party may either invoke or be bound by an arbitration clause contained in the contract. It is generally accepted that if a

third party is bound by the same obligations stipulated by a party to a contract and this contract contains an arbitration clause or, concerning it, an arbitration agreement exists, such a third party is also bound by the arbitration clause or arbitration agreement, even if it did not sign it. Note, however, that where the C(RTP)A 1999 has been expressly excluded (as it frequently is in reinsurance contracts), a non-party beneficiary may not be able to claim the benefits of that contract before an arbitral tribunal formed under the arbitration clause in the contract.

Third parties who were not originally parties to the arbitration agreement may also be bound by, or take the benefit of, an arbitration agreement in certain circumstances, including:

- if a party to the arbitration agreement has assigned or transferred contractual rights or causes of action that were subject to the arbitration agreement to a non-party;
- if an insurer is subrogated to contractual rights that are subject to an arbitration agreement; and
- if an original party to the arbitration agreement is replaced by a non-party by way of novation.

The AA 1996 provides that third parties may be bound by an arbitration agreement as a party to such agreement where they are claiming under or through a party to the agreement.

Law stated - 29 March 2023

Appeal of arbitration awards

Can parties to reinsurance arbitrations seek to vacate, modify or confirm arbitration awards through the judicial system? What level of deference does the judiciary give to arbitral awards?

Under section 58(1) of AA 1996, a tribunal's award is final and binding between the parties. However, a party may apply to the High Court to challenge an arbitration award. This may be on several grounds, including:

- where the tribunal lacked jurisdiction;
- where there were serious irregularities relating to the tribunal, the proceedings or the award; or
- unless the parties have contracted to the contrary, to address a question of law arising from an award made in the proceedings.

Depending on the nature of the application, the court may confirm, remit, vary, set aside or declare non-effective an award.

The English courts have afforded substantial deference to international arbitration proceedings, for example, in respect of the high threshold they have applied for findings of serious irregularities in such proceedings: 'It is not a ground for intervention that the court considers that it might have done things differently' (see ABB AG v Hochtief Airport GmbH [2006] EWHC 388 (Comm) , paragraph 67). Rather, an award will be annulled where the arbitral process was 'so removed from what could reasonably be expected of the arbitral process that the court should be expected to intervene' (see Latvian Shipping Company v Russian Peoples' Insurance Company [2012] EWHC 1412 (Comm)).

Law stated - 29 March 2023

REINSURANCE PRINCIPLES AND PRACTICES

Obligation to follow cedent

Does a reinsurer have an obligation to follow its cedent's underwriting fortunes and claims payments or settlements in the absence of an express contractual provision? Where such an obligation exists, what is the scope of the obligation, and what defences are available to a reinsurer?

In the absence of a contractual provision to the contrary, the burden of proof to establish that the loss was covered and that there is an actual liability for the reinsurer to pay is on the reinsured.

Follow-the-settlements clauses, which oblige reinsurers to indemnify their reinsured against compromises of the insured's claim without requiring proof of liability, are common in reinsurance agreements, as are various types of follow-the-fortunes clauses.

Claims-cooperation clauses, which impose an obligation on the insured to cooperate with the reinsurer, are also popular. The scope of the obligation and the defences available to the reinsurer is determined by the terms of the reinsurance contract.

Law stated - 29 March 2023

Good faith

Is a duty of utmost good faith implied in reinsurance agreements? If so, please describe that duty in comparison to the duty of good faith applicable to other commercial agreements.

The starting point in general commercial contracts rests on the principle of caveat emptor, which places the duty of establishing the facts that are the subject matter of the agreement on the buyer. Per contra, before the Insurance Act 2015, contracts of insurance used to be based on the principle of utmost good faith, which placed the insured under a duty to disclose all material facts and circumstances that could influence the insurer in its decision about the acceptance or the price of the risk in question. Breach of this duty used to render the insurance contract voidable.

Section 14 of the Insurance Act 2015 modifies the concept of utmost good faith in contracts of insurance by introducing a statutory duty of fair presentation in section 3 of the Insurance Act 2015. Consequently, it is no longer possible to avoid the contract of insurance on the basis that the duty of utmost good faith has not been observed. The Insurance Act 2015 introduces proportionate remedies for non-disclosure and other breaches.

Law stated - 29 March 2023

Facultative reinsurance and treaty reinsurance

Is there a different set of laws for facultative reinsurance and treaty reinsurance?

Although the two types of reinsurance operate under the same basic legal framework, historically, unlike facultative reinsurance, treaty reinsurance was generally not strictly regarded as a contract of reinsurance (see Glasgow Assurance v Symondson (1911) 16 Com Cas 109). In Citadel Insurance Co v Atlantic Union Insurance Co [1982] 2 Lloyd's Rep 543, it was held that while in facultative reinsurance the duty of disclosure exists up to the time that the reinsurer agrees to take the risk, in treaty reinsurance, although the duty exists until the conclusion of the treaty, it may not persist where the reinsurer is bound to take the risks ceded, given that there is no opportunity for the reinsurer to exercise judgment in respect of those risks. However, if treaty reinsurance or open cover enables the reinsurer to query or refuse the risks, or both, the duty of disclosure is likely to continue throughout the obligations assumed (see The Litsion Pride [1985] 1 Lloyd's Rep 437).

Law stated - 29 March 2023

Third-party action

Can a policyholder or non-signatory to a reinsurance agreement bring a direct action against a reinsurer for coverage?

As a matter of general principle, the doctrine of privity of contract prevents a person who is not a party to a contract (ie, the reinsurance contract) from relying on or having rights under the contract (eg, bringing a direct action for coverage under the reinsurance agreement). A reinsurance contract is an agreement between the reinsured and the reinsurer. The primary insured is not a party to the reinsurance agreement and therefore has no rights under it. However, unless expressly excluded by the terms of the reinsurance contract, the Contracts (Rights of Third Parties) Act 1999 (C(RTP)A 1999) enables a third party to bring proceedings under the contract where the contract expressly enables this to happen, or where the contract purports to confer a benefit on him or her. In practice, most reinsurance agreements expressly exclude the C(RTP)A 1999.

In certain circumstances a reinsurance contract may include a 'cut-through' clause, allowing a direct claim by the policyholder, but absent such a clause, the doctrine of privity would apply.

Law stated - 29 March 2023

Insolvent insurer

What is the obligation of a reinsurer to pay a policyholder’s claim where the insurer is insolvent and cannot pay?

There is no general obligation on a reinsurer to pay a policyholder’s claim in the event of the insurer being insolvent and not being able to pay the claim. However, unless expressly excluded, which in reinsurance contracts it usually is, the C(RTP)A 1999 may enable a policyholder to rely on the reinsurance policy where the insurer is insolvent and cannot pay.

The reinsurance contract will generally contain provisions as to what should happen on an insurer's insolvency. Such provisions often provide for the reinsurance to be paid to the insurer's administrator or liquidator who will then deal with policyholder claims.

Law stated - 29 March 2023

Notice and information

What type of notice and information must a cedent typically provide its reinsurer with respect to an underlying claim? If the cedent fails to provide timely or sufficient notice, what remedies are available to a reinsurer and how does the language of a reinsurance contract affect the availability of such remedies?

There are no prescribed provisions under UK law or regulation as to the notice provisions to be included in a reinsurance contract. It is for the cedent and reinsurer to agree to such terms as they see fit, and to possibly take account of basic provisions in the Interpretation Act 1978 as to timing and deemed service of notice. It is in the interests of the reinsurer to be careful as to the notice provisions, given its exposure on follow-the-fortunes and other grounds, so a reinsurance treaty would usually contain detailed provisions on service (and often seek to exclude deemed service) of notice by the cedent insurer. The basic common law rule is that the description of the event or claim must be sufficient for the reinsurer to be able to understand the nature of what is being notified, to be at liberty to

enquire further if it so elects. The consequence of failure to notify to the contractual standard as to timing and detail applicable will depend on the terms of the reinsurance contract, a key point being whether strict compliance with the notice clause has been expressed as a condition precedent (any breach of which would enable the reinsurer to avoid liability under the contract) or merely as a condition (breach of which would give the reinsurer a right to damages depending on whether the reinsurer can show loss arising from breach of the condition). Generally, it would be unusual under current UK practice for failure to provide a sufficient and punctual notification to give the reinsurer a right of repudiation of the reinsurance contract, and damages would usually (depending on the precise contractual wording) be the only realistic remedy (the loss suffered by the reinsurer due to late or inadequate disclosure (or both) being a key and potentially difficult issue for it to prove).

Law stated - 29 March 2023

Allocation of underlying claim payments or settlements

Where an underlying loss or claim provides for payment under multiple underlying reinsured policies, how does the reinsured allocate its claims or settlement payments among those policies? Do the reinsured's allocations to the underlying policies have to be mirrored in its allocations to the applicable reinsurance agreements?

The allocation of underlying claim payments or settlements depends on the wording of the reinsurance agreement. Excess of loss reinsurance is generally provided on a 'loss occurring' basis so that the reinsured must prove that it suffered the loss during the policy period. A reinsured cannot choose the order of allocation of payments or settlements. Once a layer has been exhausted, the next excess policy becomes the underlying policy. Consequently, that layer and its reinsurer are liable once the liability of the insured has been established.

Law stated - 29 March 2023

Review

What type of review does the governing law afford reinsurers with respect to a cedent's claims handling, and settlement and allocation decisions?

In the absence of a follow-the-settlement clause, the reinsured must prove the loss, as a part of which it may be necessary to review the insured's documents. In Pacific & General Insurance Co Ltd (in liquidation) v Baltica Insurance Co (UK) Ltd [1996] LRLR8, it was held that although each case depends upon its own specific facts, where the reinsurer makes a timely request for inspection of the reinsured's documents, the court is likely to grant the request (unlike in cases where the reinsurer makes an application for inspection of the reinsured's documents when a summary judgment against it is imminent).

In Commercial Union Assurance Co plc v Mander [1996] 2 Lloyd's Rep 640, the reinsurer applied for disclosure of documents relating to the insurer's liability under the original contract of insurance. The insurer argued that such documents were privileged and, in any event, unnecessary to dispose of the dispute fairly. It was held that the test of relevance was wide and included documents that may lead to a train of inquiry that may enable the party applying for discovery to either advance his or her own case or damage that of the opposing party. The test was not restricted to documents that will be admissible in evidence. Documents relating to negotiations leading to a settlement of a dispute may be relevant and disclosable.

Law stated - 29 March 2023

Reimbursement of commutation payments

What type of obligation does a reinsurer have to reimburse a cedent for commutation payments made to the cedent's policyholders? Must a reinsurer indemnify its cedent for 'incurred but not reported' claims?

The reinsurer's obligations to reimburse the cedent for its commutations with the underlying insured will depend on the terms of the reinsurance contract, particularly concerning the provisions as to follow-the-settlements and as to the claims-settlement authority vested in the cedent.

Usual follow-the-settlements clauses in the London market will generally commit the reinsurer to follow a settlement, including a commutation, made by the cedent (up to the reinsurance policy limit) where the cedent has entered into a loss settlement or compromise of liability or quantum, or both. The reinsurer will tend to be bound by a commutation payment where the cedent has entered into the commutation in a 'bona fide and business-like fashion' (Insurance Co of Africa v Scor (UK) Reinsurance [1985] 1 Lloyd's Rep 312) and so the onus will be on the reinsurer to establish a lack of bona fides or business-like dealing on the part of the cedent given that the reinsurer may be bound even if it is proved subsequently that the policy did not, in fact, create a liability to the insured or that the insured's claim was otherwise ineligible (eg, due to misrepresentation or fraud by the insured).

A well-constructed commutation agreement between a cedent and its underlying insured will include incurred but not reported claims (IBNR) within its scope, both as to valuation and to include IBNR within the full and final termination and settlement of liabilities under the commutation. From the reinsurer's perspective, IBNR by its very nature represents an estimate of claims that might be made in future but are not yet claims made under the insurance policy or loss settlements to which in either case the reinsurance would respond. Depending on the breadth of the follow-the-settlements, the reinsurer may accordingly be able to deny liability for IBNR.

Law stated - 29 March 2023

Extracontractual obligations (ECOs)

What is the obligation of a reinsurer to reimburse a cedent for ECOs?

ECOs (extracontractual obligations), stem from acts or omissions of an insurer towards its insured that are found by a court to constitute an event for which the insurer is liable to its insured outside the strict boundaries of the policy, perhaps for negligence, bad faith or misconduct (often in claims handling), and which leads to a monetary award being made against the insurer, sometimes by way of punitive damages. The sum in question is 'extra-contractual' because it falls outside the contractual bounds of the coverage provided under the insurance policy. The London Market standard ECO clause is NMX 100.

The ability of the insurer to then recover from its own reinsurers for liability to ECOs will depend on the terms of the reinsurance contract. Some reinsurance treaties include coverage for the cedent's ECOs within specific monetary and coverage limits, while others may expressly exclude ECOs or be silent on coverage for ECOs.

Coverage for ECOs will usually exclude claims arising through fraud or bad faith and may operate in excess of any concurrent errors and omissions coverage.

Given that in the United Kingdom (unlike in the United States) courts do not award punitive damages, reinsurers' concerns as to coverage of ECOs arising from an award of punitive damages against the reinsured are less acute.

Law stated - 29 March 2023

UPDATES & TRENDS

Key developments

Are there any emerging trends or hot topics in insurance and reinsurance regulation in your jurisdiction?

In October 2020, HM Treasury consulted on the Future Regulatory Framework for financial services post-Brexit. This culminated in the Financial Services and Markets Bill 2022–23 (FSM Bill) which is at the committee stage in the House of Lords, having already been through the House of Commons. The key elements of the FSM Bill are:

- establishing a framework for the revocation of financial services retained EU law;
- greater accountability over the UK regulators;
- giving the PRA and the FCA a new secondary objective to advance long-term UK economic growth and international competitiveness;
- a new regulatory principle for the PRA and the FCA to have regard to the need to ensure that their measures comply with the goal of net zero UK carbon emissions by 2050; and
- introducing new regimes that will apply to insurers in financial difficulties (see further below).

In respect of the EU, the Council agreed its position on the proposed Solvency II reform in June 2022 and must now agree a final version of the text with the European Parliament.

In respect of the UK, HM Treasury published its proposed reform package for the UK's Solvency II regime in November 2022. Some of these changes are expected to be consulted upon later in 2023.

In February 2023, the PRA published a consultation paper on dealing with insurers in financial difficulties. The consultation paper outlined in closer detail how the PRA proposes to implement the draft clauses in the FSM Bill that seek to clarify and enhance the courts' write-down powers in section 377 of the Financial Services and Markets Act 2000. The PRA expects the implementation of these changes to occur in July 2023.

In January 2023, HM Treasury published a consultation paper on the government's proposals to introduce a new dedicated Insurer Resolution Regime (IRR), which seeks to manage the failure of insurers in certain scenarios, including (1) the rapid failure of large firms; (2) multiple insurers concurrently; and (3) insurers offering 'niche' business lines where the replacement or substitute cover cannot be easily obtained. The consultation closes in April 2023.

On 5 January 2023, the Corporate Sustainability Reporting Directive (CSRD) entered into force throughout the EU. The CSRD amends the rules about the social and environmental information that certain large companies have to report. Following implementation into national law by the EU member states, the Directive's requirements will be phased in for reporting periods beginning on or after 1 January 2024. It will apply to EU insurance companies, including insurance subsidiaries of non-EU parent companies and, from 2026, will apply to captive insurance undertakings.

Law stated - 29 March 2023

Jurisdictions

China	Jincheng Tongda & Neal
Denmark	Poul Schmith/Kammeradvokaten
Germany	Clyde & Co LLP
Gibraltar	Hassans
India	Tuli & Co
Israel	Kennedys Law LLP
Japan	Nagashima Ohno & Tsunematsu
South Korea	Yoon & Yang LLC
Spain	Bird & Bird LLP
Sweden	Advokatfirman Hammarskiöld
Switzerland	Lenz & Staehelin
Turkey	Cavus & Coskunsu Law Firm
United Kingdom	Debevoise & Plimpton
USA	Sullivan & Cromwell LLP
Vietnam	LNT & Partners