Insurance & Reinsurance 2019

Contributing editors
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LEXOLOGY
Getting The Deal Through

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Lexology Getting The Deal Through is delighted to publish the twelfth edition of *Insurance & Reinsurance*, which is available in print and online at www.lexology.com/gtdt.

Lexology Getting The Deal Through provides international expert analysis in key areas of law, practice and regulation for corporate counsel, cross-border legal practitioners, and company directors and officers.

Throughout this edition, and following the unique Lexology Getting The Deal Through format, the same key questions are answered by leading practitioners in each of the jurisdictions featured. Our coverage this year includes new chapters on Mexico and Sweden.

Lexology Getting The Deal Through titles are published annually in print. Please ensure you are referring to the latest edition or to the online version at www.lexology.com/gtdt.

Every effort has been made to cover all matters of concern to readers. However, specific legal advice should always be sought from experienced local advisers.

Lexology Getting The Deal Through gratefully acknowledges the efforts of all the contributors to this volume, who were chosen for their recognised expertise. We also extend special thanks to the contributing editors, William D Torchiana, Mark F Rosenberg and Marion Leydier, of Sullivan & Cromwell LLP, for their continued assistance with this volume.

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Getting The Deal Through

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REGULATION

Regulatory agencies

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

Under the Financial Services and Markets Act 2000 (as amended) (FSMA), 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 for prudential regulation and conduct supervision of authorised firms. The PRA and the FCA are under a statutory duty to cooperate and coordinate their activities. 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 FCA and the PRA. Lloyd's managing agents are also dual-regulated by the FCA and the PRA. Members' agents and Lloyd's brokers are regulated by the FCA. The Financial Services Act 2016 makes the PRA a part of the Bank of England.

Formation and licensing

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

A firm intending to conduct insurance and reinsurance business in the United Kingdom must obtain a Part 4A FSMA permission (Part 4A permission) from the PRA (unless it is exempt or able to rely on the European Union's passporting regime). The FCA must consent to the PRA's grant of permission. Insurance intermediaries must apply to the FCA for permission. To obtain a Part 4A permission, an applicant must be able to satisfy the 'threshold conditions' on an ongoing basis. This includes demonstrating that its head office is in the United Kingdom or that it carries on business in the United Kingdom; it is adequately capitalised to conduct the insurance and reinsurance 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'.

Other licences, authorisations and qualifications

3 | 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' in the course of business in the United Kingdom. 'Regulated activities' are defined in the Financial Services and Markets Act (Regulated Activities) Order 2001 (as amended). Insurance mediation activities are regarded as regulated activities. The relevant regulator (the PRA, the FCA or both) must approve each regulated activity individually. The regulator has the power to impose restrictions on the scope of an insurer's or reinsurer's regulated activities.

The Insurance Distribution Directive ((EU) 2016/97) (IDD) amended and replaced the Insurance Mediation Directive (2002/92/EC) (IMD), entered into force on 22 February 2016 and was transposed into national law on 1 October 2018. The IDD deals with the authorisation, passporting and general regulatory requirements for insurance and reinsurance intermediaries and distributors. It also encompasses organisational and business requirements for insurance and reinsurance undertakings.

Officers and directors

4 | 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 (eg, the director, chief executive, actuary, or systems and controls functions) must be approved by the FCA or the PRA, or both, prior to performing such functions. Once approved to perform such functions, the person in question becomes subject to the Senior Insurance Managers Regime (SIMR) and accompanying Conduct Rules that impose a number of significant responsibilities, including a duty to comply with regulatory requirements, general principles and expectations on an ongoing basis. The SIMR, which came into force on 1 January 2016 for Solvency II firms – including UK branches of non-European Economic Area (EEA) firms, the Society of Lloyd's and managing agents, and insurance special purpose vehicles (ISPVs), as well as the more streamlined version of the SIMR for smaller insurers falling outside the Solvency II framework, which was introduced between 1 January 2016 and 7 March 2016 – replaced the Approved Persons Regime. The senior insurance management functions (SIMFs) are intended to be more detailed than was the case under the Approved Pensions Regime. The purpose of introducing the SIMFs was to ensure greater transparency about which individuals have responsibility for which aspects of managing the business. There is a new group entity senior manager function, which is intended to capture anyone who exercises significant influence over the management or conduct of the affairs of the UK-regulated entity and is employed by, or is an officer of, a parent or holding company. This person, regardless of his or her physical location, will need to be approved by the relevant UK regulator prior to exercising significant influence over a UK-regulated firm. New conduct rules apply to the new SIMR.

On 28 September 2016, the PRA published Policy Statement 27/16 'Strengthening accountability in banking and insurance: PRA requirements on regulatory references (Part II)'. It followed Policy Statements 5/16, 'Strengthening accountability in banking and insurance: Implementation of SM&CR [the Senior Managers and Certification Regime] and SIMR; PRA requirements on regulatory references', and 16/22, 'Strengthening accountability in banking and insurance: regulatory references', which set out requirements for obtaining regulatory references from all current and former employers in the previous six years for persons intending to exercise FCA-controlled functions, other key function holders and notified non-executive directors. On 7 March 2017, the regulatory reference requirements set out in Policy Statement 27/16 and certain SM&CR-related FCA requirements came into effect. The PRA and the FCA consulted on the extension of the SM&CR to all regulated firms, including further developing the regime for insurers in 2017. The extended regime is expected to enter into force on 9 December 2019.

In July 2017, the PRA and the FCA published consultation papers FCA CP 17/26 and PRA CP 14/17, respectively, setting out proposals to extend the SM&CR to reinsurers and managing agents. In July 2018, the FCA and the PRA published near-final rules on the extension of the SM&CR to reinsurers and managing agents. The rules entered into force on 10 December 2018.

Capital and surplus requirements

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

UK capital requirements currently adopt, but also enhance, the requirements established by the EU Insurance Directives and are contained in the PRA Handbook. Different requirements are imposed on general and life insurers, and pure reinsurers, with an overarching reserve power of the PRA to impose additional capital requirements (individual capital guidance) if deemed necessary. Pillar 1 of Solvency II, which came into force on 1 January 2016, introduced new quantitative capital requirements at both the solo entity and the group level. 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 (MCR) representing the minimum amount of capital that an insurer or reinsurer needs to cover its risks, and a solvency capital requirement (SCR), which is effectively the amount of capital that an insurer or reinsurer requires to operate as a going concern, assessed on a value-at-risk measure.

Reserves

6 | 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 calculating reserves, or 'technical provisions' according to Solvency II. Articles 76 and 77 of Solvency II set out the basic requirements as to establishment and possession of technical provisions, and as to their calculation. Unsurprisingly, reinsurers are required to establish technical provisions with respect to all their insurance and reinsurance obligations towards policyholders, and to calculate those provisions in a prudent, reliable and objective manner. The value of the technical provisions must correspond to the current amount the reinsurer would have to pay if it were to transfer its insurance and reinsurance obligations immediately to another (Solvency II-regulated) reinsurer. A major challenge introduced to the reserving process by Solvency II, however, is that the technical provisions must not only represent a best estimate, but also include a 'risk margin', each of which are to be calculated as prescribed. In addition, when calculating technical provisions, reinsurers must segment their insurance and reinsurance obligations into homogenous risk groups and by lines of business as prescribed, hence raising specific allocation issues.

In 2017, the PRA conducted its General Insurance Stress Test and was able to confirm that UK reinsurers in aggregate and at an individual level met the threshold resilience requirements of Solvency II, and that on the 'reinsurance interconnectedness' test the concentration of risk placed with specific individual reinsurers had actually fallen, with an increasing role being played by alternative capital (such as the insurance-linked securities market).

The European Commission is conducting a 2018 review of capital requirement calculations under Solvency II, recognising that the final 2016 requirements of Solvency II were in some cases based on 2011 methodology and thinking. The 2018 review identifies three priorities: proportionality; consistency with other financial legislation; and removal of undue barriers to financing. The European Insurance and Occupational Pensions Authority (EIOPA) is due to report on these issues.

Product regulation

7 | 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. It 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 selling retail products) must be mindful of the need to 'pay due regard to the interests of customers and treat them fairly' and 'pay due regard to the information needs of clients and communicate information to them in a way which 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 (such as 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 with regard to 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 must be provided to the buyer before the insurance contract is formed.

Regulatory examinations

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

US-style examinations of insurers and reinsurers 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 and regulatory intervention, if required. Regulatory oversight is usually exercised by the FCA (as to conduct) and the PRA (as to prudential matters) working together pursuant to a memorandum of understanding. Underpinning the oversight function are the duties imposed on insurers and reinsurers under the General Principles for Business, which are applied by both the FCA and the PRA. Financial reporting and financial requirements were already provided for in the PRA Handbook, and have been supplemented by Solvency II requirements from 1 January 2016. Both the FCA and the PRA conduct visits and in-person interviews with insurers and reinsurers on a regular basis.

Investments

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

Insurers are required to hold eligible assets to cover their technical provisions, and to maintain an adequate available solvency margin on top of the technical provisions. Solvency II has introduced a less prescriptive regime as to the nature and identity of eligible assets, focusing instead on broader quality criteria for the assets concerned if they are to form part of the requisite 'own funds' that are to comprise the MCR and the SCR. Capital of the highest quality will be eligible to be categorised as Tier 1, and capital of lower quality will be Tier 2 or Tier 3. Tier 1 is divided into 'restricted' and 'unrestricted' Tier 1 capital. The types of assets eligible to be 'own funds' within the three Tiers are classified in articles 69 to 78 of Commission Delegated Regulation (EU) 2015/35. Solvency II has removed many of the previous restrictions under the General Prudential Sourcebook as to admissibility and percentage holding of assets, and instead has given insurers greater freedom to invest in assets that are appropriate to their business and to their individual solvency capital requirement.

Change of control

10 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?

Because of Part XII of FSMA, a person must not acquire or increase control in a UK-regulated insurance or reinsurance 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 because of a 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 insurer or reinsurer or its parent above 20, 30 or 50 per cent. 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.

Directors and officers of the proposed acquirer may need to apply to become senior managers in respect of exercising senior management functions in the regulated target entity, and will be subject to background investigations.

Financing of an acquisition

11 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 an insurance or reinsurance company. Where the acquirer is itself an insurance or reinsurance 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 or targets would either come within the financial assistance regime under Part 18(2) of the Companies Act 2006, or otherwise impact the regulatory capital position of the acquirer or the target or targets. There are no specific UK rules mandating or prohibiting any particular acquisition financing method.

Minority interest

12 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 is able to exercise significant influence over the management of the insurer or reinsurer, which could trigger a requirement for change of control approval. Otherwise, the regime described in question 10 will apply.

Foreign ownership

13 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 an insurance or reinsurance company by foreign citizens, companies or governments. The same change of control rules apply as discussed in question 10.

Group supervision and capital requirements

14 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 concepts of '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, both at the level of the authorised insurance and reinsurance 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 Three regulatory and public disclosure requirements for groups.

The group supervisor under Solvency II will usually be the supervisor in the state where 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 entity.

Primary disclosures are made through annual solvency and financial condition reports (SFCR), as well as through public disclosure of the SCR. In addition to the annual SFCR, a regular supervisory report will need to be submitted on an annual basis (but does not need to 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, must be calculated at least annually. The consolidated group SCR is the sum of the capital requirements of all the entities in the group. Group solvency must be calculated in accordance with the accounting consolidation method, the deduction and aggregation method, or a combination of both methods. The accounting consolidation method is the default method for the calculation of group capital requirements. 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 subgroup level.

The implementation and effectiveness of the SCR standard formula under the Solvency II framework was reviewed by EIOPA, with the findings being delivered to the European Commission in 2018. The Solvency II regime as a whole will be reviewed by 2021 (or earlier, depending on the outcome of Brexit negotiations). Following the result of the Brexit referendum on 23 June 2016, the United Kingdom will no longer be a part of the European Union by 2021. A Treasury Select Committee was established in September 2016 to look into EU insurance regulation. 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 European Commission about the 'equivalence' post-Brexit status of the United Kingdom in terms of the requirements of Solvency II. Even though, at present, the United Kingdom has fully implemented the requirements of Solvency II, third country 'equivalence' decisions are a matter for the European Commission.

Reinsurance agreements

15 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 regime prescribing the content, scope or application of reinsurance contracts governed by English law. In the United Kingdom, reinsurance is generally regulated in the same way as primary insurance, and English law on insurance contracts generally applies likewise to reinsurance agreements.

Ceded reinsurance and retention of risk

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

Cedents will have to consider a number of 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. A reinsurer that is authorised as an 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 as regards prudential requirements, and risk assessment monitoring and control. Solvency II requires insurers to establish and maintain adequate technical provisions with respect to all of their insurance and reinsurance obligations towards policyholders (article 76). To the extent that an insurer has entered into risk mitigation techniques (such as reinsurance), Solvency II and the PRA Rulebook provide detailed requirements as to how the amounts recoverable under reinsurance contracts and ISPVs are to be calculated (Appendix 1, PRA Rulebook).

Collateral

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

There are no prescribed forms of collateral to be put up by reinsurers under English law or UK regulation. The ceding insurer and the reinsurer are at liberty to agree whatever form of collateral (if, indeed, any) they choose. From December 2008, the Reinsurance Directive has prohibited member states from requiring EEA reinsurers (but not non-EEA reinsurers) to pledge assets to cover their part of the cedent's technical provisions. 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 the EU Financial Collateral Directive (2002/47/EC), which facilitates the enforcement of security over financial collateral within the European Union. Under Solvency II, member states are no longer able to impose on reinsurers from an 'equivalent' jurisdiction (or another member state) collateral requirements that require the pledging of assets to cover unearned premiums and outstanding claims provisions (article 173).

On 13 January 2017, representatives of the European Union and the United States issued a joint statement announcing that they had successfully concluded negotiation of a bilateral agreement between the them on prudential measures regarding insurance and reinsurance (the 'Covered Agreement' within the meaning of the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 in the United States, and an 'agreement' under article 218 of the Treaty on the Functioning of the European Union in the European Union), which will ensure robust insurance consumer protection and provide enhanced regulatory certainty for insurers and reinsurers operating in both the United States and in the European Union. The Covered Agreement addresses three areas of prudential insurance regulation important to internationally active reinsurers: reinsurance; group supervision; and the exchange of information between insurance supervisors. The key aspects of the Covered Agreement are intended to provide EU-based reinsurers with relief from US collateral requirements, provide US-based reinsurers with relief from EU local presence requirements, and free US insurance groups operating in the European Union from EU worldwide group capital, solvency, reporting and governance requirements under Solvency II, and applicable implementing legislation.

On 20 December 2018, representatives of the United States and the United Kingdom announced that they had signed a bilateral agreement between them on prudential measures regarding insurance and reinsurance (the UK–US Covered Agreement) on 18 December 2018, to provide regulatory certainty and market continuity as the United Kingdom prepares to leave the European Union. The US–UK Covered Agreement addresses (i) the elimination of local presence requirements imposed by one party on an assuming reinsurer that is domiciled in the country of the other party, (ii) the elimination of collateral requirements imposed by a party on an assuming reinsurer that is domiciled in the country of the other party, and (iii) the role of the host and home supervisory authorities with respect to prudential group supervision of an insurance or reinsurance group whose worldwide parent undertaking is in the country of the home party.

Credit for reinsurance

18 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 the purposes of 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) at 1.1.19 is 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 (such as 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 (Chapter 7) on valuation of recoverables from reinsurance contracts and ISPVs (implementing article 81 of Solvency II) should be read with that in mind. Reference should also be made to Commission Delegated Regulation (EU) 2015/35, which sets out rules relating to technical provisions.

Insolvent and financially troubled companies

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

Under Part XXIV of FSMA, the UK regulators (PRA and FCA) are given the right to be involved in insolvency proceedings against insurers. The insolvency proceedings available in the United Kingdom 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 (the 2004 Regulations), the Insolvency Act 1986, Part XXIV of FSMA 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 United Kingdom, and applies to insurers as it applies to other corporate entities, procedures for the appointment of administrators and liquidators, and for 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 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 Regulation 2017 provides for the introduction into UK law of the protected cell company (PCC) so as to accommodate 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 Chapter 17 of the Risk Transformation Regulation 2017.

Claim priority in insolvency

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

The 2004 Regulations provide, inter alia, that preferred creditors (being those with preferential debts such as monies due to Her Majesty's Revenue and Customs, 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 (with the exception of 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, 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 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.

Intermediaries

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

The IDD applies to and requires authorisation of both independent intermediaries (such as insurance brokers) and insurers and reinsurers insofar as they conduct insurance and reinsurance mediation activities. The IDD also provides for 'passporting' by intermediaries 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 insurers and reinsurers, including as to 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 of establishment. Insurance intermediaries require authorisation from the FCA primarily, but if the intermediary is part of a group that includes a firm authorised by the PRA, the FCA will also have to consult with the PRA before granting any Part 4A FSMA permission for insurance mediation. The IDD includes a number of exclusions and exemptions from the need for intermediaries to be authorised, and the United Kingdom will retain 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. The IDD was required to be implemented into the national laws of EU member states by 1 October 2018.

INSURANCE CLAIMS AND COVERAGE

Third-party actions

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

Because of 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 abovementioned third-party actions do not apply to reinsurance contracts.

Late notice of claim

23 | 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 p247, 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, notwithstanding that 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.

Wrongful denial of claim

24 | 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. See question 50 on extra-contractual liabilities.

Defence of claim

25 | 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.

Indemnity policies

26 | 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).

Incontestability

27 | 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.

Punitive damages

28 | 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.

Excess insurer obligations

29 | 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.

Self-insurance default

30 | 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 prior to 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.

Claim priority

31 | 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.

Allocation of payment

32 | 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 coinsurer'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.

Disgorgement or restitution

33 | 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. However, restitution claims are capable of being an insurable loss.

Definition of occurrence

34 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 a number of 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, 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.

Rescission based on misstatements

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

The Insurance Act 2015, which came into force on 12 August 2015, abolished 'basis of contract' clauses in insurance contracts. These 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 judgement 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.

REINSURANCE DISPUTES AND ARBITRATION

Reinsurance disputes

36 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 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 prior to 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.

Common dispute issues

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

Jurisdiction is one of the most common issues that arises in reinsurance disputes (see *Faraday Reinsurance Co Ltd v Howden North America Inc & Another* [2012] EWCA Civ 980). In addition, 'follow-the-fortunes' and 'cut-through' clauses are also often disputed.

Arbitration awards

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

It is a well-established principle of English law that arbitral awards must give reasons for their decision. Arbitrations that have their seat in England and Wales are governed by the Arbitration Act 1996. Section 52(4) of the Arbitration Act 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 Arbitration are commonly used arbitral institutions with their own independent rules to govern the proceedings. Most London arbitrators will follow the procedure of the Commercial Court, particularly in relation to evidence and reasons for the decision.

Power of arbitrators

39 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. 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, in relation to it, an arbitration agreement exists, the third party is also bound by the arbitration clause, or arbitration agreement, even if it did not sign it. However, where the Contracts (Rights of Third Parties) Act 1999 has been expressly excluded, 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.

Appeal of arbitration awards

40 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 the Arbitration Act 1996, a tribunal's award is final and binding between the parties. However, a party may apply to the English courts to remit, set aside or declare non-effective an award on a number of grounds, including where the tribunal lacked jurisdiction, where there were serious irregularities in the arbitral proceedings or, unless parties agree to the contrary, to address a question of law arising from an award made in the proceedings.

A party to arbitral proceedings may (upon notice to the other parties and to the tribunal) apply to the court challenging an award in the proceedings on the ground of serious irregularity affecting the tribunal, the proceedings or the award.

English courts have afforded procedural decisions in international arbitrations substantial deference: 'It is not a ground for intervention that the Court considers that it might have done things differently' (*ABB AG v Hochtief Airport GmbH* [2006] EWHC 388, paragraph 67). Rather, an award will be annulled only if the arbitral process was 'so removed from what could reasonably be expected of the arbitral process that the Court should be expected to intervene' (*Latvian Shipping Co v* Russian Peoples' *Ins Co* [2012] EWHC 1412 (Comm)).

REINSURANCE PRINCIPLES AND PRACTICES

Obligation to follow cedent

41 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 are determined by the terms of the reinsurance contract.

Good faith

42 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. However, prior to 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.

Facultative reinsurance and treaty reinsurance

43 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, although 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 judgement 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).

Third-party action

44 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 does not have any rights under it. However, unless expressly excluded by the terms of the reinsurance contract, the Contracts (Rights of Third Parties) Act 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 Contracts (Rights of Third Parties) Act 1999.

In *Shirley Redman (Administratix of the Estate of Peter Redman, Deceased) v (1) Zurich Insurance Plc; (2) ESJS1 Ltd (AKA the Humber Electrical Engineering Co Ltd)* [2017] EWHC 1919 (QB), Turner J held that under section 1 of the Third Parties (Rights Against Insurers) Act 2010, anyone who had become insolvent for the purposes of the Act incurred a liability when the damage was caused, not when a claimant had established a right to compensation. The transitional provisions did not provide for the 2010 regime to be applied retrospectively. However, Schedule 3 to the 2010 Act expressly made it clear that the Third Parties (Rights against Insurers) Act 1930 continued to apply where, before 1 August 2016, someone had become insolvent for the purposes of the 2010 Act and had incurred a liability against which they were insured.

In *BAE Systems Pension Funds Trustees Ltd (Applicant/Claimant) v Royal & Sun Alliance Insurance Plc (Respondent) & (1) Bowmer & Kirkland Ltd; (2) Geofirma Soils Engineering Ltd; (3) Twintec Ltd. (in administration); (4) Te Little & K Bent (practising as Sprigg Little Partnership) (Defendants)* [2017] EWHC 2082 (TCC), O'Farrell J held that for a claimant to apply under section 2 of the Third Parties (Rights Against Insurers) Act 2010 to join an insurer as a co-defendant to proceedings against its insured, it was not necessary for the claimant to establish that the insured was liable under the claim or that the insurance policy covered such liability. Section 2 provided a mechanism for establishing liability.

Insolvent insurer

45 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 Contracts (Rights of Third Parties) Act 1999 may enable a policyholder to rely on the reinsurance policy where the insurer is insolvent and cannot pay.

Notice and information

46 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 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, so as 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).

Allocation of underlying claim payments or settlements

47 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.

Review

48 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 reinsurer must prove its 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.

Reimbursement of commutation payments

49 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 with reference to the provisions as to follow-the-settlements clauses 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 (IBNR) claims within its scope, both as to valuation and so as to include IBNR claims within the full and final termination and settlement of liabilities under the commutation. From the reinsurer's perspective, IBNR claims by their very nature represent 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 clause, the reinsurer may accordingly be able to deny liability for IBNR claims.

Extra-contractual obligations (ECOs)

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

ECOs (or extra-contractual damages) 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, whereas others may expressly exclude ECOs or be silent on coverage for them.

Coverage for ECOs will usually exclude 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.

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