Insurance Update.

Old Mutual Preferred Securities

Old Mutual plc has made a £350 million issue of perpetual preferred callable securities with an initial coupon of 6.376%. The issue, which launched on 15 March 2005, will fund the general activities of the Old Mutual financial services group. It will qualify as innovative tier one capital under the regulatory requirements of the Financial Services Authority.

Linklaters acted on the issue for the joint bookrunners, Barclays Capital and UBS Investment Bank, the managers, Lloyds TSB and Royal Bank of Scotland, and the trustee, HSBC Trustee (C.I.) Limited.

Developments In France

Bessé Group

Linklaters recently acted for the Bessé Group, the largest insurance broker in France. The transaction involved the leveraged buy-out of Bessé's life and health insurance brokerage business. The deal closed on 1 February 2005.

Winding up and reconstruction of insurers

EU Directive 2001/17/EC on the winding up and reconstruction of insurance undertakings has been implemented in France nearly 2 years late. The directive provides for proceedings involving the winding up and reconstruction of EEA insurance undertakings to be the responsibility of their home state (that is to say the state where their head office is based) and to be recognised in other member states.

Decree 2005-8 of 5 January 2005 transposed the Directive by amendments to existing statutory provisions (particularly the French Insurance Code).

The controversial Article 10 of the Directive, which provides for insurance claims to have priority in an insolvency, did not need implementation. This is already provided for in Article 327-2 of the Code. The Code also gives special priority over the assets representing the technical provisions and guarantees of non EEA insurance undertakings. That priority operates for the benefit of those claiming under insurance contracts underwritten or entered into in the territory of the French Republic.

This last mentioned provision may, perhaps, be vulnerable to challenge on the basis that it amounts to indirect discrimination on the grounds of nationality.

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Insurance mediation

A bill was published in March 2005, the main purpose of which is to implement in France EU Directive 2002/92/EC on Insurance Mediation. The bill expands the scope of mediation activities currently regulated under French law, but, surprisingly, does not apply to activities which exclusively consist in claims handling. In this respect it seems to fall short of the Directive requirements.

In accordance with the Directive a system for registration of intermediaries is created, together with rules for inwards and outwards passporting. Insurers and intermediaries may only transact business with other intermediaries who have been registered or have validly passported. The maximum fee for registration will be €250.

There are new rules on what pre-contractual information should be provided to prospective policyholders. In their application to life assurance these provisions also bring French law into line with the EU Consolidated Life Assurance Directive.

Comment

The process of transposing these rules seems to be considerably less burdensome and complex in France than it was in the United Kingdom. This is partly, no doubt, because the Directives apply legal principles which are already to some extent inherent in continental legal systems. The UK implementation of the Insurance Mediation Directive is also superequivalent to the Directive requirements in a number of respects.

The proposed exclusion of claims handling from the proposed definition of insurance mediation may, perhaps, make it difficult for some foreign intermediaries to carry on business in France.

Financial Reinsurance

Financial reinsurance transactions have been a focus of regulatory interest over the last year. On the one hand they can be a legitimate mechanism for improving the regulatory return and financial health of an insurer and helping it to raise funds, but on the other hand they are sometimes used as a device to inflate its balance sheet without any real transfer of risk to the reinsurer.

In some cases these devices have been used without adequate disclosure of all relevant circumstances to the regulator. This happened, for instance, in the case of the Equitable Life Assurance Society. When the truth has subsequently emerged enforcement action has invariably followed. Where the reinsurer is, or should have been, aware of any intention to mislead the regulator it too may be implicated. Issues of this kind have arisen not only in the UK but also in North America and Australia.

The regulatory position in the UK is not satisfactory. In CP144, published in July 2002, the FSA published draft guidance on the use by insurers of "financial engineering" of which financial reinsurance is a subset. Its recent pronouncements indicate that it expects insurers to comply with this draft guidance although it has not completed the formal consultation and adoption process contemplated under the Financial Services and Markets Act 2000.

On 16 March the FSA wrote on this subject to general insurers and reinsurers whom it subjects to risk assessment. It asked them a number of questions concerning their use of financial engineering.

No doubt this intiative will lead in due course to a fuller statement of the FSA's policy.

Morris Review Of Actuarial Profession

Sir Derek Morris completed his review of the actuarial profession last month. His recommendations have been welcomed by the Government. They include:

- the creation of an actuarial standards board within the Financial Reporting Council to oversee the regulation of the profession,
- more market testing and tendering in the market for actuarial services,
- better systems to address conflicts of interest that may arise in the exercise of actuaries' functions (for instance when they advise both pension scheme trustees and the scheme sponsor)
- independent scrutiny of scheme actuaries' advice under the supervision of the Pensions Regulator.

Morris also supports the FSA's introduction of the role of the Reviewing Actuary and recommends that the FSA should consult on:

- the introduction of a requirement for actuarial advice as part of the audit in both the company market and the Lloyd's market for general insurers, and
- a requirement for general insurers to take advice from an approved person (who may or may not be an actuary) on reserving and risk assessment issues.

Jurisdiction

The decision of the High Court in *Royal & Sun Alliance Insurance plc v Retail Brand Alliance*, 14 September 2004, is a reminder of the importance of jurisdiction issues in insurance claims. The country in which an insurance claim is litigated will often significantly influence the outcome. In the FSA's new risk based capital adequacy regime insurers are expected to maintain

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systems for managing operational risk of which legal risk is a subset. Moreover jurisdiction is an aspect of contract certainty, another current FSA theme.

Of all foreign jurisdictions, the USA is often seen as the one for European insurers to avoid, if possible, since it is common in the USA to claim penal damages and to make substantial claims against insurers who are alleged to have put forward unjustified defences.

The policy in the RSA case was issued to Marks and Spencer plc and covered all companies in the group including a US subsidiary, Retail Brands. The policy was expressly governed by English law. RSA, therefore, issued court proceedings in the UK against Retail Brands with a view to pre-empting proceedings in New York. The judge, Mr. Justice Langley, stayed the English action on the basis that the New York courts were the more convenient forum and that the issues in the case were factual rather than legal.

This course would not have been open to the judge if there had been a jurisdiction clause in the policy, or if Retail Brands had been a UK domiciled entity (the European Court made a ruling to this effect last month). Even a New York arbitration clause might have been better than nothing at all, since it would have avoided jury trial in the New York courts.

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