Linklaters

September 2010

Insurance Update.

Head for the heights

The Linklaters insurance team look forward to seeing a number of you at our reception at Vertigo 42, Tower 42, London on Thursday, 30 September 2010. From the top floor of the tallest occupied building in the City of London, you can enjoy spectacular views of the sunset over six counties, with canapés from the Michelin Star restaurant, Rhodes Twenty Four.

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European Parliament approves new pan-EU supervisory structure

Following months of negotiations between the European Union Parliament, Council and Commission, on 22 September the Parliament gave the final seal of approval to a new EU financial supervision architecture which will see the creation of a European Systemic Risk Board (whose purpose will be to identify systemic threats emanating from the EU financial system) and three additional watchdogs to police the banking, securities and insurance markets. Although day-to-day supervision will remain with national supervisors, the new bodies will be empowered to overrule national counterparts and issue decisions directly to a financial institution in certain situations (for example, where national supervisors cannot agree between themselves, or where a state of emergency has been declared by the European Union Council). The new bodies will also be able to investigate or even ban financial activities or products which they consider too risky. The new bodies are expected to be operational by January of next year and will be based in London, Paris and Frankfurt.

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European Commission Green Paper on corporate governance and Linklaters' response

The European Commission published a Green Paper on corporate governance in financial institutions and an accompanying Staff Working Document in June 2010. The Green Paper raises questions about corporate governance in financial institutions specifically (which would include insurance companies) but also includes provisions about remuneration in listed companies generally. Below we highlight the key themes raised in the Green Paper and Linklaters' response to it.

Corporate governance in financial institutions

The Green Paper covers a broad range of corporate governance topics, such as the composition and functioning of boards, the role of shareholders, auditors, risk-related functions and conflicts of interest. Some of the questions posed seem to challenge fundamentally some current concepts of the relationship between shareholders, directors and their companies. Specific questions raised include the following:

> Should the civil and criminal liability of directors be reinforced?

> Should a specific duty be established for the board of directors to take into account the interests of depositors and other stakeholders ("duty of care")?

> Could the functioning and efficiency of boards be improved by increasing the number of women and individuals with different backgrounds?

> Should the number of boards on which a director may sit be limited?

> Should external evaluations be made compulsory with the results being published to shareholders?

> Should it be compulsory to set up a risk committee?

> Is shareholder control of financial institutions still realistic and what would improve shareholder engagement in practice?

Although the Green Paper does not make specific proposals for reforms, its general approach and tone together with that of the Staff Working Document suggest that the Commission believes legislative measures are needed to tighten up corporate governance in the EU. This would run counter to the approach of allowing corporate governance to be based on codes and "comply or explain" principles, which currently exists in many member states.

Remuneration

In the Green Paper, the European Commission notes that implementation by Member States of its 2009 Recommendations (on the remuneration of executives of listed companies and on remuneration in the financial services sector) has been "neither uniform nor satisfactory".

The European Commission indicates that it is considering the need for legislative measures to regulate the remuneration of the directors of listed

companies in general and seeks views on whether additional measures are needed and, if so, what form they should take. Specific questions include:

> Whether stock options and similar types of remuneration encourage excessive risk-taking and need to be regulated or prohibited?

> Whether the role of employees in establishing remuneration policy should be strengthened?

> Should severance packages ("golden parachutes") be prohibited?

> Should the variable elements of remuneration in financial institutions that have received public funding be reduced or suspended?

Linklaters' response

In summary, Linklaters takes the view that given the wide variety of financial institutions, it will not be effective to determine one set of new detailed rules applicable to all those institutions.

The effective implementation of corporate governance principles, which exist in a broad variety in many member states, is better achieved through regulatory supervision based on broad principles. These include, where necessary, the coordination of regulatory activities across member states.

The above view is based on our assumption that in most member states the supervisory authorities already have sufficient powers to exercise the required supervision on financial institutions. In particular the assessment and pre-approval of individuals carrying out governance functions within financial institutions should be an effective instrument to achieve a proper functioning of decision-making bodies in financial institutions.

Furthermore, some of the conclusions and observations in the Green Paper appear not to be exclusive to financial institutions such as the questions of conflicts of interest, the powers of boards of directors to exercise effective control over senior management and the discussion on the role of shareholders. Consequently, they should not form the subject of a singular legislative proposal directed at financial institutions only.

Corporate governance in listed companies generally

The Commission has also stated that it will soon launch a broader review on corporate governance within listed companies. It is likely that the views expressed by the Commission and its staff in the Green Paper and the Staff Working Document will be a basis for this broader review. Linklaters will follow these developments and keep you informed.

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or your usual contact at Linklaters.

Appointment of arbitrators

Arbitration clauses are commonly used in agreements within the Insurance sector. A recent decision of the Court of Appeal of England and Wales has rendered void an arbitration agreement which required that all arbitrators be members of a specific religious community on the basis that such a provision is contrary to domestic anti-discrimination legislation. Moreover, the Court held that this particular provision could not be severed from the arbitration agreement and struck down the arbitration agreement in its entirety. Both parties to the case have applied to appeal the decision and, therefore, the ultimate outcome is uncertain. However, the current decision has generated considerable discussion within the arbitral institutions and the international legal community because of its wider potential implications.

> **New arbitration agreements**: the principal arbitration rules which are regularly incorporated in arbitration agreements (including the LCIA, ICC and UNCITRAL rules) include restrictions on the appointment of arbitrators on the basis of nationality. The issues raised by the current decision may ultimately be resolved either following a successful appeal or by amendments to institutional rules. However, both of these are long term solutions which are likely to take some time to implement. In the meantime, therefore, we are advising our clients to include the following sentence in new arbitration clauses in contracts governed by English law to reduce the risk that an institutional arbitration clause may be held void as a consequence of the restrictions on the nationality of arbitrators which are contained in the institutional rules:

> *"Any provision of such Rules relating to the nationality of an arbitrator shall to that extent not apply."*

> **Existing arbitration agreements**: with regard to existing arbitration clauses, we do not advise that clients renegotiate or amend existing arbitration agreements, particularly as the longer term solution to these issues remains unclear. We can, of course, advise on any specific arbitration agreements in respect of which our clients have concerns.

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Recent Deals

Our recent deal experience in the sector (details of which we are able to disclose) include:

> advising Unibreda Comm.V on the sale to CIGNA Holdings Overseas, Inc of Vanbreda International NV, a Belgian company which designs, implements and manages cross-border health insurance and employee benefits programmes for intergovernmental and non-governmental organisations, multi-national corporations and their international workforce, as well as individual expatriates. Vanbreda International NV has offices and sales representations in 14 countries across Europe, the Middle East, Africa, Asia, Latin America and the USA;

> advising Janikowskie Zaklady Sodowe JANIKOSODA S.A. and Inowroclawskie Zaklady Chemiczne SODA MATWY S.A., subsidiaries of a Polish listed company Ciech S.A., on the conditional sale to Gothaer Finanzholding AG of 45.42% of the shares in Polskie Towarzystwo Ubezpieczen S.A., a Polish insurance company; and

> advising Hannover Ruckversicherung AG and Hannover Finance (Luxembourg) S.A. on the issue of a hybrid bond being the first German hybrid bond aimed at meeting the anticipated requirements to qualify as tier 2 regulatory capital under the Solvency II regime.

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