

## LEGAL FOCUS

# Implications of directive

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NON-European Union (EU) reinsurers have traditionally benefited from a liberal regulatory framework for their reinsurance activities within the EU. It is clear that this relaxed position could not escape review with the adoption of the new Reinsurance Directive which member states must implement by December 21 this year.

The directive puts in place a harmonised supervisory and prudential framework for EU reinsurers and creates a level playing field for their cross-border activities. Not surprisingly, it does not allow non-EU reinsurers into this exclusive club.

All is not lost for non-EU reinsurers wanting to continue their activities within the EU. There is no indication yet that the lack of a common framework will necessarily hamper their activities, but they will need to reassess their position in the light of implementation in each member state and the emergence of Solvency II.

#### Lack of harmonisation for non-EU reinsurers

Member states remain free to introduce a specific prudential and supervisory regime for non-EU reinsurers wishing to do business on their territory. If they do not implement such a regime, they would still be entitled to impose additional requirements on a case-by-case basis, under the general caveat in Article 49 of the directive whereby "a member state shall not apply [to third-country reinsurers] provisions which result in a treatment more favourable than that accorded to reinsurance undertakings having their head office in that member state".

This injunction means that member states must review the action necessary to ensure that a third-country reinsurer cannot transact business solely on the basis of a more relaxed supervisory regime in its home country. As a result, the conditions under which a third-country reinsurer might establish

**GUY SOUSSAN and PHILIP WOOLFSON, from Steptoe & Johnson, examine the implications of the Reinsurance Directive which must be implemented across the EU by the end of the year**

branches or transact cross-border business could vary significantly in the EU.

#### Subsidiaries of non-EU reinsurers

Conversely, where a non-EU reinsurer sets up a subsidiary in a member state, that subsidiary will be treated like any other EU reinsurer. National rules on the treatment of non-EU reinsurers would not be applicable in such a scenario. The EU subsidiary will be subject to the same prudential and solvency standards, but will also benefit from full passport rights.

Article 52 of the directive requires reciprocity: it would allow member states to apply restrictive provisions if the legislation of the country in which the parent company is located does not, in turn, grant effective market access to EU reinsurance companies.

#### EU branches of non-EU reinsurers

In contrast to the other EU insurance directives, the Reinsurance Directive does not provide a common framework for the establishment of branches by non-EU reinsurers. The regulatory treatment of such branches is therefore left entirely to the member states.

The draft implementing legislation of some member states indicates that a local branch might not require authorisation. However, certain solvency and prudential requirements might be imposed, eg, technical provisions and a solvency margin in relation to local business, a requirement for an EU depositary, localisation of assets and local prudential reporting.

This approach will not be uniform: for example, the Irish legislation does not provide a specific framework for non-EU reinsurers but leaves open the possibility of applying stricter rules on a case-by-case basis under Article 49. Other countries might maintain some form of indirect supervision of local cedants rather than enact a specific regime for reinsurance branches.

#### Cross-border business by non-EU reinsurers

Under the directive, an EU reinsurer can carry on its activities in other member

states via a branch or on a freedom of services basis. A non-EU reinsurer with a branch in a member state has no EU right to provide cross-border business in another member state either in its own right or via a branch; it does not have a passport. It would have to comply with the rules of that other member state and, possibly, open another branch.

The capacity of member states to accommodate non-EU reinsurers could therefore be significant, particularly following the recent European Court of Justice judgment in a case involving a credit institution, *Fidium*. There, the court confirmed that the treaty does not confer on non-EU service providers the right to provide services within the EU.

It is unlikely member states will want to further restrict cross-border operations by non-EU reinsurers. Yet they could maintain some form of indirect supervision at the level of EU cedants, by limiting credit given to cedants for third-country reinsurance. The directive would permit member states to maintain or introduce new collateral requirements in respect of business ceded by local insurers to non-EU reinsurers.

Some form of indirect supervision at the level of EU cedants might survive once Solvency II is in place. The commission is seeking greater convergence at national level but anticipates that member states may link additional supervision to the results of a prior equivalence assessment of the home country of the reinsurer and to the reinsurer's rating. CEIOPS has prepared draft advice to the commission along those lines.

#### Mutual recognition of reinsurance supervision

Given the diverging treatment, which could arise from the lack of harmonisation, Article 50 of the directive empowers the commission to negotiate with third countries to conclude mutual recognition agreements.

The objective would be to ensure "effective market access" for reinsurers in both directions and to provide for "equivalence of prudential



regulation" and "mutual recognition of supervisory rules and practice".

The prospects of bilateral agreements could be of particular interest to third-country reinsurers located in major markets such as Bermuda, the US and Switzerland. A prerequisite for starting negotiations will be that the regime of the third country should already be quite close to EU standards. This is likely to exclude the US, at least until resolution of the collateral issue.

It seems that Switzerland would be a more likely candidate for such negotiations: the Swiss reinsurance supervisory regime largely mirrors and to some extent goes beyond EU standards, at least pending Solvency II.

#### What future for non-EU reinsurers?

Conclusion of mutual recognition agreements with third countries will be a long-term and complicated exercise. Meanwhile, member states are expected to clarify, for their own jurisdiction, the conditions for market access by non-EU reinsurers. The discretion left to member states suggests that a fragmented approach is a likely result.

Non-EU reinsurers may perhaps take comfort from the fact that most member states intend to show self-restraint and pragmatism in their future treatment of non-EU reinsurers. They are currently discussing with the commission how to improve convergence but the scope for progress is limited.

Third-country reinsurers need to review operating structures, in the light of their EU activities and implementation of the directive in the member states. They should bear in mind this is not a once-and-for-all exercise: the treatment of non-EU reinsurers will remain an issue as the fundamental review of the EU supervisory framework evolves.

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