

# INSURANCE DAY



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## Third-country insurers: on the outside looking in



**PHILIP WOOLFSON and GUY SOUSSAN** look at the rules governing how insurers outside the EU write business inside it

These directives do not expressly prohibit third-country insurers from insuring risks situated in the EU, although they do include reciprocity requirements for access to their country markets, albeit never activated.

Instead, the directives set out "rules applicable to agencies and branches established within the community and depending on undertakings whose head office is outside the community". These rules include a general principle that access to insurance business by a third-country insurer is subject to an official authorisation and to fulfilment of various prudential requirements similar to those applicable to an insurer incorporated in the EU.

In the banking sector, this principle was recently confirmed in a European Court of Justice judgment regarding their operations in Germany of a Swiss credit institution, Fidium.

Authorisation of an agency or branch of a third-country insurer is, however, geographically limited to the member state in question. This means that authorisation granted to, for example, the London branch of a US carrier does not entitle the US carrier to use the "passport" regime of the directives to operate in other member states; only insurance undertakings incorporated and authorised in an EU member state can use the passport.

Third-country reinsurers have traditionally enjoyed easier access to the EU market. The Reinsurance Directive maintains broad discretion to member states to grant access. Practical experience with this directive suggests that many member states exercise self-restraint to ensure that incoming reinsurers compete on the same terms as domestic players (*IDnewscentre*, Jan 19, 2007).

Finally, EU member states regulate access to their markets in accordance with national rules. These are a patchwork. Often, national laws will apply the "situation of the risk" test of the directives and expressly prohibit any underwriting of a local risk (eg, Belgium).

Other states may have a general prohibition but admit exceptions (eg, the MAT exception in France). Even if the policy is void, a policyholder in good faith may still be allowed to enforce it.

Rather than the situation of the risk, the focus is sometimes on conduct of a regulated activity in the state (eg, the UK).

Yet other member states may allow the local policyholder to take the initiative to conclude the contract with the third-country insurer (eg, Luxembourg and Germany).

A policy which is void or challengeable because of the lack of authorisation is problematic. Claims that have already been settled, as well as commissions paid to the intermediary, may be impossible to recover.

Alternatively, the policyholder might claim repayment of premiums. The insurer is unlikely to recover corresponding insurance premium tax. Reinsurance taken out to cover the primary risk will also be challengeable on misrepresentation or similar grounds.

In addition to regulation of insurers and reinsurers, (re)insurance intermediaries are also subject to a harmonised set of rules at the EU level under the Insurance Mediation Directive. This directive does not have specific third country rules.

Instead, it requires EU-authorised companies to work exclusively through EU-registered and supervised intermediaries. This means that, for example, the London branch of a US insurer may not be able to accept a risk situated in the EU brokered by an intermediary which is not registered in the EU.

### The tax dimension

Another key issue for third country insurers in the EU is tax, in particular insurance premium tax (IPT). Member states retain the power to levy IPT. The result is messy: each member state sets its own rules for the scope, rate and administration of IPT; likewise, rules vary immensely regarding liability for IPT – whether the policy holder, intermediary or insurer.

In practice, IPT compliance can result in contradictory and rather approximate allocations, in particular in multi-jurisdictional programmes. At the same time, the European Court's severe judgment in *Kvaerner* in 2003, resulting in allocation of IPT among the different entities or risks covered by a master policy, has imposed further compliance obligations on insurers.

National IPT rules also frequently require the appointment of a fiscal representative. This is a costly and time-consuming requirement for insurers.

Thankfully, last year's European Court judgment in *Commission vs Belgium* has provided some welcome relief from disproportionate fiscal



representative requirements. Direct taxes (eg, corporate income tax) can also be an issue for a third-country insurer. An insurer which sets up an authorised branch is also, in all probability, creating a taxable permanent establishment. Even where the insurer has no branch, and accepts coverage on a non-admitted basis, a tax authority might still argue that the placing intermediary is itself a taxable permanent establishment of the insurer.

### Addressing the risk

Third country insurers need to stick to admitted business or rely on any national waiver or use alternative structures such as fronting arrangements. An insurer which neglects authorisation issues may create various exposures:

- The risk of regulatory enquiry into the basis of authorisation resulting in public alerts and warnings and sanctions such as fines. The insurer may also face questions from its home supervisor;
- The risk that the policy is void or, at least, challengeable;
- The tax risk, whether indirect (IPT) or direct (corporate income);
- Reputational risk through disruption of relations with policyholders and intermediaries; and
- "Legacy" and internal audit and compliance questions, ie the build-up of a portfolio of doubtful business.

Fronting, captive and reinsurance arrangements represent sensible and practical alternatives. They create costs but these are no lower than remedying the costs of non-compliance. The case for international liberalisation is more compelling than ever.

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