Writing admitted versus non-admitted insurance in the EU

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Third country insurers, i.e., insurers domiciled outside the EU that seek to cover risks situated in the EU, can come within the scope of European rules even if they are only occasional players and have no European establishment. This article considers the regulatory framework and opportunities for writing "non-admitted" business.

Multinational companies with global risks need coverage which will be valid in all relevant jurisdictions. Risk managers and intermediaries seek out policies with worldwide cover. They are attracted by a single provider, premium and claims procedure under a policy that a single intermediary brokers for a single commission. Unfortunately, these insurance buyers remain bound by national rules, the effect of which is to subject a single, master policy to myriad national variants in terms of authorisation, conformity with local law and tax, etc. Despite extensive liberalisation in the EU, a third country insurer that seeks to cover risks within the EU might still detect a whiff of "Fortress Europe".

Layers of regulation

The regulatory framework for insurance is international, European and national in its scope and effects. At the international level, the principal binding text for insurance regulatory matters is the General Agreement on Trade in Services, which forms part of the trade liberalisation work of the World Trade Organization. Insurance is a service within the scope of GATS, but, to date, GATS has only fostered limited liberalisation of the sector.

At the European level, the insurance 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.

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 United States 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. Many states do.

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. Other states may have a general prohibition against third-country insurers but admit exceptions. Rather than the situation of the risk, the focus is sometimes on the conduct of a regulated activity in the state. Other member states may allow the local policyholder to take the initiative to conclude the contract with the third country insurer.

A policy which is void or challengeable because of the lack of authorisation is problematic in terms of premiums, commissions and claims, and the reinsurance for the policy.

In addition to regulation of insurers and reinsurers, (re)insurance intermediaries are also subject to a harmonised set of rules at 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.

The tax dimension

Another important issue for third country insurers in the EU is tax, in particular insurance premium tax. Member states retain the power to levy IPT. The result is messy with myriad rules on the scope, rate and administration of IPT.

In practice, IPT compliance can result in contradictory and rather approximate allocations, in particular, in multi-jurisdictional programmes. The European Court's severe judgment in *Kvaerner* in 2003 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, notwithstanding last year's useful European Court judgment in *Commission vs. Belgium*.

Direct taxes, e.g., 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.

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.
- The risk that the policy is void or, at least, challengeable.
- The tax risk, whether indirect (IPT) or direct (corporate income).
- Reputational risk.
- "Legacy" and internal audit and compliance questions.

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.

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