MAYER • BROWN

Global Corporate Insurance & Regulatory

BULLETIN

December 2011

Brazil - Brazilian Reinsurance Market Outlook

A year after the enactment of Resolutions 223/2010 and 224/2010 by the Brazilian National Private Insurance Council (**"CNSP"**), Brazilian insurance regulators are pointing out that the number of local reinsurers (licensed to carryout reinsurance in Brazil) has doubled from 6 to 12.

This set of controversial regulations, initially scheduled to become effective on 31 March 2010, directly affected the reinsurance market, including foreign reinsurers with branches in Brazil. The regulations provided two significant changes: (i) local reinsurers would no longer have the right of first offer on 40% of reinsurance cession, instead there would be the obligation to contract at least 40% of any reinsurance risk with local reinsurers; and (ii) local reinsurers could no longer transfer any liability under insurance, reinsurance or retrocession undertaken in Brazil to any parent or affiliated reinsurance company abroad.

The market reacted with strong complaints, challenging the validity of such rules and claiming that both the CNSP and the Brazilian Superintendence of Private Insurance (**"SUSEP"**) did not hold a public consultation prior to enacting such rules – a breach of the routine procedure which caught the various members of the market by surprise. The intense debate in the media that followed forced the government to finally publish Resolution CNSP 232/2011 (on 28 March 2011) that revoked Resolution 224/2010 and permitted local insurers to transfer 20% of their risks undertaken in Brazil to parent or affiliated companies based abroad. Furthermore, each insurance and reinsurance company is now responsible for monitoring compliance with the 20% threshold. However, risks associated with performance bonds, exportation credits, internal credits, nuclear risks and rural are not subject to the 20% limit, and may be transferred freely. The obligation to contract 40% of reinsurance risks with local reinsurers, however, remains valid.

The increase in the number of local reinsurers celebrated by the Brazilian Government is openly recognised by major players, who are stating that the costs of accessing the 40% exclusive market is worth it in relation to the largely increasing Brazilian insurance market. 2012 is expect to inaugurate an even greater number of local reinsurers who have already applied for licensing with SUSEP.

EU – European Commission letter to EIOPA regarding equivalence

On 22 November 2011 the European Commission (the **"Commission"**) wrote to the European Insurance and Occupational Pensions Authority (**"EIOPA"**) thanking them for their assessments on the equivalence of the Swiss, Bermudan and Japanese solvency and prudential regimes. The letter can be accessed here.

The Commission commended "*the quality of EIOPA's reports*" and welcomed EIOPA's commitment to revisit the reports once the final level 2 implementing measures have been agreed in order to verify whether any amendments are needed, and to consider,

at the same time, whether any changes made to the regimes in the relevant countries affect the conclusions in their initial reports.

The Commission commented that it expects its decision on the equivalence of the countries will be made during the first half of 2013.

The Commission went on to state what it saw EIOPA's role to be in relation to transitional measures for Solvency II equivalence, being:

1. carrying out an assessment of whether persons working for, or on behalf of, the supervisory authorities are bound by obligations of professional secrecy equivalent to those under Solvency II; and
2. identifying the areas where the third country supervisory regime does not meet the equivalence criteria at present (here, the Commission only expects a high level analysis, to include steps that would need to be taken by the third country supervisory regime in order for the equivalence criteria to be met).

The Commission has identified 16 third countries that are potential candidates for a transitional regime and, once they have gauged their interest in being part of such a regime, will provide EIOPA with a final list of third countries for which assessments should be carried out. This list is expected by the end of January 2012, and the Commission will require assessments to be completed by the end of 2012.

EU – EIOPA letter to European Parliament regarding reporting

EIOPA has published a letter to the European Parliament (**"EP"**) dated 16 December 2011 in relation to reporting under Solvency II (the **"Letter"**).

EIOPA has expressed strong concerns about an EP Solvency II proposal (which has not yet been made available to the public) (the **"Proposal"**) in relation to small and medium sized enterprises and the regulatory supervisory report.

In particular, EIOPA are of the opinion that the area of quarterly and line by line reporting to supervisors, covered in the Proposal, would achieve *"precisely the opposite effect"* as the EP is aiming for, namely reducing the burden to undertakings without diminishing the level of protection to policyholders. They point out that *"without proper and sufficient information, effective supervision is not possible"*, and that owing to such a lack of regular information supervisors would have to carry out on-site visits more often, increasing the burden to insurers.

EIOPA have requested a role in both discussing the Proposal and, after the implementation of the reporting requirements, in performing a full cost benefit analysis to identify ways to improve the requirements at that stage, if needed. They also suggest that a formal request to EIOPA to work on proportionality, rather than setting thresholds, could be a better solution.

EU – Progress report on Omnibus II

The EP has recently amended its schedule for consideration of the proposed Omnibus II Directive.

The next stage is for a vote to take place in the Economic and Financial Affairs Committee (**"EFAC"**), which is now scheduled for 23 January 2012.

It is then anticipated that the EP will consider Omnibus II during a plenary session held between 17 and 20 April 2012.

It was previously expected that the EFAC vote would take place on 20 December 2011 and the plenary discussion between 12 and 15 March 2012, so both amendments represent a delay to the timetable for the progression of Omnibus II.

UK – UK government response and consultation in relation to Test-Achats judgement

On 8 December 2011 HM Treasury published the 'UK response to the 1 March European Court of Justice ruling that insurance benefits and premiums after 21 December 2012 should be gender-neutral'. This contains both their proposed response to *Association belge des Consommateurs Test-Achats and others (Case c-236/09)* (**"Test-Achats"**) and also a consultation on consequential amendments to the Equality Act 2010.

As noted in earlier bulletins, in Test Achats the ECJ ruled that using gender as a risk factor should not result in differences in premiums and benefits for men and women.

Mark Hoban, Financial Secretary to HM Treasury, issued a statement on 30 June 2011 which noted the government's disappointment with the judgement, which it expects to negatively impact consumers rather than the industry. The government is of the opinion that *"nobody should be treated unfairly because of their gender, but that financial services providers should be allowed to make sensible decisions based on sound analysis of relevant risk factors"*. However, Test-Achats is nevertheless binding in UK law.

The government believes that Test-Achats will have three main outcomes for consumers, being:

1. cross-subsidisation of premiums between the genders;
2. increasing the cost of insurance generally and incentivising riskier behavior; and
3. in the the context of motor insurance, having consequences for road safety.

They believe the impact for industry will mainly be that:

1. the lowest-risk categories of consumer, who stand to lose the most from the change, may leave the marker or take a lower level of cover, which will affect revenues; and
2. transitional costs will be incurred in changes to underwriting practices, marketing and sales approaches.

The government is asking for comments on proposed new regulations (the Equality Act 2012 (Amendment) Regulations 2012) and on other Test-Achats related issues. These include:

- views on whether the impacts set out in the impact assessment (which is part of the consultation) are reasonable;
- the scope of indirect discrimination in insurance and related financial services;
- the definition of a 'new contract' in the draft regulations; and
- whether any amendment is needed to paragraph 20 of Schedule 3 to the Equality Act (which creates an exception for insurers who provide insurance pursuant to arrangements made by an employer for its employees, and other persons, as a consequence of their employment).

The consultation is open until 29 February 2012. HM Treasury has committed to publishing a summary of the results of the consultation within three months of this date. The government is intending to pass legislation to implement Test-Achats in early 2012, to come in force from 21 December 2012.

UK – Court of Appeal upholds decision that extended warranties are contracts of insurance

On 29 November 2011 the Court of Appeal upheld a High Court decision that two entities should be wound up for carrying on insurance business without FSA authorisation (*Digital Satellite Warranty Cover Ltd v The Financial Services Authority [2001] EWCA Civ 1413*) (**"Digital Satellite"**).

The FSA secured winding-up orders from the High Court in January 2011. It had sought the orders as it was concerned that the firms involved, who were offering cover that they described as an 'extended warranty' in relation to Sky satellite TV equipment, were in fact offering contracts of insurance.

The FSA issued a press release about the decision in Digital Satellite on 29 November 2011. In the press release the FSA's acting director of enforcement and financial crime, Tracey McDermott, commented that "*the decision will help protect satellite TV customers from inadvertently dealing with an unauthorised business*" and that the decision "*serves as a useful reminder to other firms that offer similar cover that they may need to seek authorisation*".

The FSA noted that the problem was not limited to firms offering cover for satellite TV, and that it had also seen cover offered for white goods, home entertainment equipment, electricity, plumbing and boiler problems. They stated that "*consumer should take a moment to consider who they are dealing with and whether or not that firm needs to be FSA authorised*".

The appellants have 28 days from 29 November 2011 to seek permission from the Supreme Court to appeal the Court of Appeal's decision.

US – Update on the Federal Insurance Office

Over recent months, the Federal Insurance Office (the **"FIO"**) has been actively communicating with the insurance industry and further defining its role within the insurance regulatory landscape. In the meanwhile, legislation has been proposed to limit the ability of the FIO to obtain information from insurance companies through its subpoena powers.

Federal Insurance Office Conference

On 9 December 2011, the FIO held a conference entitled "Insurance Regulation in the United States: Modernization and Improvement." Attendees and participants at the conference included insurance regulators, government officials, consumer organizations and members and experts from the insurance industry. The purpose of the conference was to allow the FIO to continue its outreach process to key industry figures and to discuss certain aspects of the insurance industry, including the assessment of industry opinions on the study and report on the modernization and improvement of U.S. insurance regulation required to be submitted by the FIO to Congress by Title V of the Dodd-Frank Wall Street Reform and Consumer Protection Act (the **"Dodd-Frank Act"**). In addition to an analysis of the current state of insurance regulation, the FIO report is to include any legislative, administrative or regulatory changes that the FIO Director deems appropriate to implement the improvements to the regulatory system proposed in the report. The report is due to be presented to Congress in January 2012. FIO Director Michael McRaith has stated that the FIO anticipates meeting the January deadline for the report, but that the initial report will discuss only the FIO's most important findings and points. In advance of the FIO conference, the FIO met with regulators and staff from the National Association of Insurance Commissioners to exchange information regarding financial regulation, including recent enhancements to the regulatory system, and recent market conduct issues and processes.

Challenge to Subpoena Powers of the Federal Insurance Office

Under Section 313(e)(6) of Title V of the Dodd-Frank Act, the FIO Director has the power to subpoena insurers and affiliates in order to collect data that the FIO may reasonably require to carry out its functions. However, on 5 December 2011, House of Representatives Bill 3559 of the 112th Congress, known as the "Insurance Data Protection Act", was introduced by Representative Steve Stivers of Ohio with a stated purpose to "prohibit the Federal Insurance Office of the Department of Treasury and other financial regulators from collecting data directly from an insurance company." The bill would strike Section 313(e)(6) of Title V of the Dodd-Frank Act, thus revoking the subpoena powers of the FIO Director with regard to collecting data from insurers directly. The bill would also eliminate the ability of the Office of Financial Research to subpoena insurance companies. The bill further bolsters the confidential treatment of data collected from insurance companies by financial regulators, and contains a provision for "advance coordination" that requires financial regulators to coordinate with federal agencies and state insurance regulators to obtain data regarding insurance companies before attempting to obtain such data directly from an insurance company. As of 5 December 2011, the bill has been referred to both the United States House Committee on Financial Services and the United States House Committee on Agriculture.

Background on the Federal Insurance Office

The FIO was established under the Department of Treasury by Title V of the Dodd-Frank Act. The primary responsibility of the FIO is to monitor the insurance industry and identify issues or gaps in current insurance regulation that could contribute to a systemic crisis in the insurance industry or the U.S. financial system. The FIO is tasked with making recommendations to the Financial Stability Oversight Council (the **"FSOC"**) regarding insurance companies that should be designated as systemically important financial institutions. Such a designation could result in a company being subjected to supervision by the Board of Governors of the Federal Reserve System and the imposition of prudential standards on such company in accordance with Title I of the Dodd-Frank Act. The FIO Director serves as a non-voting member of the FSOC. The FIO works closely with the FSOC's independent insurance expert, Roy Woodall, and the FSOC member selected by state insurance regulators, Director of the Missouri Department of Insurance, John Huff. Among its other functions, the FIO collects and analyzes information regarding the insurance industry, develops and coordinates federal policy on prudential aspects of international insurance matters, evaluates the accessibility and affordability of insurance products for low- and middle-income Americans and advises the Secretary of Treasury on insurance issues. Despite the functions that the FIO serves on a national level, the FIO does not itself serve as an insurance regulator or supervisor. The power to regulate insurance remains reserved to individual states. The FIO is a full member of the International Association of Insurance Supervisors (the **"IAIS"**). The IAIS, along with a number of individual and regional jurisdictions, has recently been considering various regulatory reform regimes to address the potential risks to the global financial system presented by the insolvency of a large insurer or insurance group.

Former Illinois Director of Insurance, Michael McRaith, was named as the first director of the FIO in March 2011. In November 2011, the Department of Treasury made appointments to positions on the Federal Advisory Committee on Insurance (**"FACI"**), an advisory body that was established to provide advice, recommendations, analysis and information directly to the FIO. FACI is comprised of fifteen persons, largely from state insurance regulator positions, but it also includes members from varying backgrounds such as members currently working in the business of insurance, in academia and in consumer advocacy.

US – New York becomes the 18th state to enact legislation addressing the treatment of qualified financial contracts under insurance insolvencies

It finally happened. On 12 December 2011, New York Governor Andrew Cuomo signed Senate Bill 2713A into law. The bill, which was passed by the legislature in June, adds important provisions to the New York Insurance Law regarding the treatment of qualified financial contracts in an insurance insolvency proceeding. New York is the 18th state to have enacted provisions governing the treatment of qualified financial contracts under insurance insolvencies based on the 2005 amendments to the Insurance Receivership Model Act (**"IRMA"**) of the National

Association of Insurance Commissioners. "Qualified financial contracts" include derivatives, securities lending, repurchase agreements, futures contracts and other financial instruments. These contracts are typically documented under master agreements providing for netting of obligations between the parties. The agreements also establish a right of the non-defaulting party to close out, liquidate and terminate the agreements immediately upon the insolvency of the other party and provide for collateralization of obligations on a net, rather than gross, basis. While both the U.S. Bankruptcy Code, which governs the insolvency of most U.S. companies, and the Federal Deposit Insurance Act, which governs the insolvency of U.S. banks, contain provisions exempting qualified financial contracts and netting agreements from the automatic stay mechanism, most state insurance codes governing the insolvency of insurance companies have historically not included such provisions, creating significant uncertainty for counterparties of insurance companies. This uncertainty has led to reluctance on the part of banks and other financial institutions to enter into swap agreements with insurance companies out of concern that they may be unable to exercise termination, netting and collateral realization rights under the agreements if the insurer becomes insolvent. The IRMA provisions should alleviate the concerns of counterparties dealing with insurers that are domiciled in the 18 states that have enacted those provisions, which are Arizona, Connecticut, Delaware, Illinois, Indiana, Iowa, Maine, Maryland, Massachusetts, Michigan, Minnesota, Missouri, Nebraska, New York, Ohio, Texas, Utah and Virginia. Similar legislation has also been introduced in New Jersey.

US – Update – CFTC issues final order amending effective date of swap regulation

On 19 December 2011, the Commodity Futures Trading Commission (the **"CFTC"**) issued a final order (the **"Final Order"**) regarding the effective date of swap regulation under the Dodd-Frank Act. Certain provisions of the Commodity Exchange Act (the **"CEA"**) addressing the regulation of swaps were originally scheduled to take effect on 16 July 2011, the general effective date of the Dodd-Frank Act. On 14 July 2011, recognizing that the rulemaking process had not progressed to a point sufficient to enact the pending swap regulations, the CFTC granted temporary exemptive relief from certain provisions of the CEA until 31 December 2011. On 25 October 2011, the CFTC published in the Federal Register a Notice of Proposed Amendment proposing an extension of the temporary exemptive relief granted on 14 July 2011 until possibly 16 July 2012. After a period during which parties were invited to submit comments on the Notice of Proposed Amendment, the CFTC has issued the Final Order, under which the CFTC has determined to retain an outmost expiry date of 16 July 2012 for the exemptive relief granted from the relevant provisions of the CEA with respect to swap regulation.

For more information on the Notice of Proposed Amendment and the extension of the effective date of swap regulation, please see our article from the October 2011 Mayer Brown Global Corporate Insurance & Regulatory Bulletin, CFTC proposes extension of effective date of swap regulation.

MAYER BROWN OFFICES

Americas	Asia	Europe	Alliance Law Firm Offices
Charlotte	Bangkok	Berlin	Barcelona
Chicago	Beijing	Brussels	Bucharest
Houston	Guangzhou	Cologne	Florence
Los Angeles	Hanoi	Frankfurt	Madrid
New York	Ho Chi Minh City	London	Mexico City
Palo Alto	Hong Kong	Paris	Milan
São Paulo	Shanghai		Padua
Washington DC			Rome
			Tirana

If you have any query in connection with anything in this Bulletin, please do not hesitate to get in touch with your usual Mayer Brown contact or one of the contacts referred to below.

If you have any query in connection with anything in this Bulletin, please do not hesitate to get in touch with your usual Mayer Brown contact or one of the contacts referred to below.

Co-Editor

Martin Mankabady
Partner
+44 20 3130 3830
mmankabady@mayerbrown.com

Co-Editor

David Alberts
Partner
+1 212 506 2611
dalberts@mayerbrown.com

Co-Editor

Lawrence Hamilton
Partner
+1 312 701 7055
lhamilton@mayerbrown.com

Deputy Editor

Annemarie Payne
Associate
apayne@mayerbrown.com

Learn more about our Insurance Industry Group.

Mayer Brown is a global legal services organization advising many of the world's largest companies, including a significant portion of the Fortune 100, FTSE 100, DAX and Hang Seng Index companies and more than half of the world's largest banks. Our legal services include banking and finance; corporate and securities; litigation and dispute resolution; antitrust and competition; US Supreme Court and appellate matters; employment and benefits; environmental; financial services regulatory & enforcement; government and global trade; intellectual property; real estate; tax; restructuring, bankruptcy and insolvency; and wealth management.

OFFICE LOCATIONS AMERICAS: Charlotte, Chicago, Houston, Los Angeles, New York, Palo Alto, Washington DC
ASIA: Bangkok, Beijing, Guangzhou, Hanoi, Ho Chi Minh City, Hong Kong, Shanghai, Singapore
EUROPE: Berlin, Brussels, Cologne, Frankfurt, London, Paris

TAUIL & CHEQUER ADVOGADOS in association with Mayer Brown LLP: São Paulo, Rio de Janeiro

ALLIANCE LAW FIRM: Spain (Ramón & Cajal)

Please visit our web site for comprehensive contact information for all Mayer Brown offices. www.mayerbrown.com

Mayer Brown is a global legal services provider comprising legal practices that are separate entities (the "Mayer Brown Practices"). The Mayer Brown Practices are: Mayer Brown LLP and Mayer Brown Europe–Brussels LLP, both limited liability partnerships established in Illinois USA; Mayer Brown International LLP, a limited liability partnership incorporated in England and Wales (authorized and regulated by the Solicitors Regulation Authority and registered in England and Wales number OC 303359); Mayer Brown, a SELAS established in France; Mayer Brown JSM, a Hong Kong partnership and its associated entities in Asia; and Tauil & Chequer Advogados, a Brazilian law partnership with which Mayer Brown is associated. "Mayer Brown" and the Mayer Brown logo are the trademarks of the Mayer Brown Practices in their respective jurisdictions.

© 2011. The Mayer Brown Practices. All rights reserved.

0327ins
December 2011