MAYER • BROWN

Global Corporate Insurance & Regulatory

BULLETIN

January 2012

Contents

	Page
Europe – European Commission issue guidelines following Test-Achats ruling	1
Europe – Solvency II potentially delayed by two years	2
UK – VAT on payments for the transfer of an insurance business	2
US – Illinois continues to pursue credit for reinsurance reform	3
US – NAIC Captive & SPV Use Subgroup Holds Inaugural Meeting	4
US – Dodd-Frank update: CFTC approves final rules regarding swap dealer sand major swap participants	6
US – CPSS & IOSCO issue a final report on OTC derivatives reporting and aggregation requirements	6

Europe – European Commission issues guidelines following Test-Achats ruling

On 22 December 2011, the European Commission (**"EC"**) published a press release and guidelines (the **"Guidelines"**) on the application of the Gender Directive (2004/113/EC) (the **"Directive"**) in light of the decision of the European Court of Justice (**"ECJ"**) in *Association Belge des Consommateurs Test-Achats and others (Case C-236/09) [2009] ECJ* (**"Test-Achats"**).

The EC stated that, following consultations with national governments, insurers and consumers, the Guidelines respond to the need for practical guidance on the implications of Test-Achats. Viviane Reding, the EU's Justice Commissioner, commented that *"it is now up to the insurance industry to ensure that there is a smooth transition to fully equal treatment of men and women in insurance. The [EC] will remain vigilant in how the industry implements the [ECJ's] ruling".*

The Guidelines centre around the following:

1 Clarification that Test-Achats only applies to 'new contracts'. The Guidelines also include specific examples of what is considered a 'new contract'.

   - The EC comments that the objective of this rule is to avoid a sudden readjustment of the market.
   - Contracts concluded for the first time as from 21 December 2012, and agreements between parties concluded as from 21 December 2012 to extend contracts concluded before that date which would otherwise have expired, will be 'new contracts'.
   - However, the automatic extension of a pre-existing contract, adjustments made to individual elements of an existing contract where the consent of the policyholder is not required, taking out top-up or follow-on policies whose terms were pre-agreed in contracts concluded before 21 December 2012 where these policies are activated by a unilateral decision of the policyholder, and the mere transfer of an insurance portfolio from one insurer to another, will not be 'new contracts'.

2. Examples of gender-related insurance practices which are compatible with the principle of unisex premiums and benefits, and therefore will not need to change because of Test-Achats.

   - The EC comments that the Directive does not prohibit the use of gender as a risk-rating factor in general – it can be used in the calculation of premiums and benefits at an aggregated level, as long as it does not lead to differentiation at individual level.
   - Therefore, insurers will remain able to collect and use gender status for their internal risk assessment, gender can still be used in the pricing of reinsurance, it remains possible for insurers to use marketing and advertising to influence their portfolio mix, and in light of certain physiological differences between men and women, there are some medical related risk factors on the basis of which differentiation is possible (for more on this, see Annex 3 of the Guidelines).

The EC was also keen to clarify that Test-Achats does not mean that women will always pay the same car insurance premiums as men.

Europe – Solvency II potentially delayed by two years

The next stage in the legislative process for Omnibus II, the vote in the European Parliament's Economic and Monetary Affairs Committee (**"ECON"**), was due to take place on 23-24 January 2012 but has now been postponed to 21 March 2012. It is believed that this vote has been delayed to allow ECON more time to discuss key issues relating to Omnibus II and Solvency II.

Although the anticipated date for the first plenary sitting currently remains unchanged from 17 April 2012, a leading German manager close to Brussels proceedings has recently announced that implementation of Solvency II may well be delayed for two years. The delay in the ECON vote apparently means that there is not enough time for the Parliament, the Commission and the Council to complete its Trilogue process before the summer recess, meaning that implementing measures may not be agreed before 2013. As European insurers have been promised a period of at least 18 months to manage the change, this means 2015 may be the first possible date for initial implementation. If the current plan to have a year between implementation and activation for firms is retained, this would mean full activation would not occur before 2016.

However, a spokesperson for the Commission has said that such a delay is "*pure speculation*" and that it remains committed to the deadline of full implementation by 1 January 2014. This deadline is described as "*still achievable*", despite the Commission's admission that it would be put under pressure by the delay of the ECON vote.

UK – VAT on payments for the transfer of an insurance business

Prudential agreed to transfer its general insurance business to a number of companies in the Winterthur group. A number of agreements were signed, including a reinsurance and administration agreement, a marketing agreement, a renewal rights agreement and a business sale agreement. Prudential received an upfront payment in consideration for the transfer, as well as commissions payable under the marketing agreement arising on insurance contract renewals. The High Court considered whether the commission payments were subject to VAT.

It was argued that the commission payments were exempt from VAT on two grounds.

Firstly, it was argued that the transfer of the business from Prudential to Winterthur was a transfer of a going concern (**"TOGC"**) for VAT purposes and therefore neither a supply of goods nor services. The commission payments were part of the consideration for a TOGC and therefore no VAT arose. This was rejected by the High Court.

Secondly, it was argued that the commission payments were for insurance brokerage or agency services and therefore exempt from VAT. The High Court said that the exemption did not apply in these circumstances, since Prudential, in acting under the contracts, did not bring together Winterthur and the insured parties. To meet the exemption, Prudential would have had to be engaged in putting insurance companies in touch with potential clients and providing services which were vital to that

process. Prudential merely passed on renewal information to Winterthur and this did not constitute the provision of "brokerage" or "agency" services.

In rejecting both these arguments, the High Court therefore found that the commission payments were subject to VAT.

The case provides further guidance on the (narrow) meaning of "insurance broker" for the purposes of VAT and emphasises the need for the broker to bring together the insurer and the insured.

The case also shows that careful consideration needs to be given to the VAT liabilities on sales and purchases of insurance businesses. The assumption that there is going be no VAT needs to be fully tested.

US – Illinois continues to pursue credit for reinsurance reform

Two bills were newly introduced to the 97th General Assembly of the State of Illinois with the aim of amending the existing credit for reinsurance laws of the state. On 18 January State Representative Greg Harris introduced House Bill 3987, while on 24 January State Senator Antonio Muñoz introduced the nearly identical Senate version of the bill as Senate Bill 2864.

The proposed legislation would make a significant change to the credit for reinsurance rules of Illinois by potentially allowing full credit to insurers that cede insurance to unauthorized reinsurers that post less than 100% collateral. The Illinois legislation largely follows recent changes to the National Association of Insurance Commissioners (**"NAIC"**) Credit for Reinsurance Model Law (#785) and Credit for Reinsurance Model Regulation (#786) that were adopted by the NAIC Executive Committee and Plenary at the 2011 NAIC Fall Meeting. The NAIC models are influential as accreditation standards, and other states in addition to Illinois may choose to amend their laws and regulations in the upcoming year to conform to the models. A small number of states have already enacted provisions similar to the amended models, with Florida having led the way in 2008. Similar legislation proposed in Illinois in 2011 was not enacted, but this year's legislation may receive a boost from the fact that the newly designated Director of Insurance for Illinois, Andrew Boron, has previously expressed support for the reforms.

For a discussion of the progression of reinsurance collateral requirements reform in the US, please see our article, *US reinsurance collateral reform picks up pace*, which can be found here. For more information on the NAIC Fall 2011 Meeting, please see our article from the October 2011 Mayer Brown Global Corporate Insurance & Regulatory Bulletin, *NAIC Fall 2011 Meeting Notes*.

Under the newly proposed legislation in Illinois, credit would be allowed to a domestic insurer when reinsurance is ceded to an assuming insurer that has been "certified" by the Illinois Director of Insurance (the **"Director"**) as a reinsurer and that secures its obligations in accordance with the requirements of the Illinois Insurance Code. In order to be eligible for certification, an assuming insurer would have to meet certain requirements including being domiciled and licensed in a "qualified jurisdiction" as determined by the Director under the statute, maintaining

financial strength ratings, maintaining minimum capital and surplus, submitting to the jurisdiction of Illinois, meeting filing requirements and satisfying any other requirements of the Director. The Director would assign a rating to each certified reinsurer, giving consideration to the financial strength ratings of the certified reinsurer. Most importantly, the proposed legislation provides that a certified reinsurer would need to secure its obligations at a level consistent with its ratings, as specified in forthcoming rules adopted by the Director, opening the door for the possibility of risk-based collateral requirements where a certified reinsurer could post less than 100% collateral, with the ceding insurer still receiving credit for the ceded reinsurance.

The proposed legislation also contains provisions concerning the concentration of risk. Under the proposed legislation, a ceding insurer would have to take steps to manage its reinsurance recoverables proportionate to its own book of business. A domestic ceding insurer would be required to notify the Director within 30 days after reinsurance recoverable from any single assuming insurer, or group of affiliated assuming insurers, exceeds 50% of the domestic ceding insurer's last reported surplus to policyholders, or after it is determined that reinsurance recoverables are likely to exceed this limit. The proposed legislation also provides that a ceding insurer would need to take steps to diversify its reinsurance program and notify the Director within 30 days after ceding to any single insurer, or group of affiliated assuming insurers, more than 20% of the ceding insurer's gross written premium in the prior calendar year, or after it is determined that the reinsurance ceded is likely to exceed this limit. In both situations the notification to the Director would be designed to facilitate the Director's oversight of the domestic ceding insurer by requiring it to demonstrate that it is safely managing its exposures.

US – NAIC Captive & SPV Use Subgroup Holds Inaugural Meeting

The Captive & SPV Use Subgroup (the **"Subgroup"**) of the NAIC Financial Condition (E) Committee held its inaugural meeting by conference call on Friday 27 January 2012. This Subgroup was established at the Fall NAIC meeting in November 2011 and consists of representatives from the insurance departments of Texas, Michigan, Missouri, New Jersey, New York, South Carolina and Vermont. Also participating with the Subgroup as non-voting, monitoring members on behalf of the E Committee are Superintendent Joe Torti of Rhode Island and Deputy Commissioner Steve Johnson of Pennsylvania. As chair of the Subgroup, Doug Slape, of the Texas Department of Insurance, led the conference call through the three agenda items: the Subgroup's charge, a draft survey, and the Subgroup's work plan.

The Subgroup's formal charge from the NAIC is to "*Study insurers' use of captives and special purpose vehicles (**"SPVs"**) to transfer third-party insurance risk in relation to existing state laws and regulations and establish appropriate regulatory requirements to address concerns identified in this study. The appropriate regulatory requirements may involve modifications to existing NAIC model laws and/or generation of a new NAIC model law.*"

In discussing the charge, there was a consensus of the Subgroup that the scope of the Subgroup's work is to focus on captives and SPVs that are owned by insurance companies or insurance holding companies and that take on third-party risk by reinsuring their affiliates – rather than traditional, pure captives or risk retention groups that are used by businesses to manage their own risks. One of the motivations that was mentioned for establishing the Subgroup was a concern by some regulators with the lack of consistent requirements for the use of captives and SPVs, particularly with respect to capital requirements. The Subgroup noted that the charge specifically includes captives/SPVs that reinsure life XXX reserves.

The Subgroup had previously released for comment a draft questionnaire on the use of captives and SPVs by insurance companies. On the conference call, the Subgroup decided to use the questionnaire initially to survey only state insurance regulators, not insurance companies themselves. The Subgroup plans to develop a subsequent survey or other method of obtaining company input at a later date. Individual responses to the questionnaire will be confidential (i.e. non-attributable to specific jurisdictions), and only an aggregated results summary will be prepared and circulated for industry comment. The regulators' responses to the survey will be due by 20 February 2012 so that the Subgroup can discuss the results at the NAIC Spring meeting in New Orleans on 2 March 2012.

Finally, the Subgroup discussed its proposed work plan and timing. The work plan that was agreed upon contemplates holding nine conference calls after the Spring NAIC meeting with an aim of releasing a draft "proposal" for comment by the end of July 2012 in order to discuss the "proposal" and comment letters at the Summer NAIC meeting in August 2012.

The use of captives and SPVs by insurance companies themselves has increased over the last several years and the number of states that compete for that captive and SPV business has increased as well. To date, for example, four states have adopted statutes allowing life insurers domiciled in their states to create limited purpose subsidiary (**"LPS"**) life insurance companies. Those states are Georgia, Indiana, Iowa and Texas. More broadly, a number of states continue to join the ranks of states with captive laws, including most recently New Jersey in 2011. In addition, a significant number of jurisdictions also have enacted special statutes enabling the use of special purpose financial captives – not only traditional captive jurisdictions like Vermont, South Carolina and Hawaii, but also Connecticut, Delaware, the District of Columbia, Michigan, Missouri, Nebraska, Tennessee and Utah. For details on some of these developments, please see our article from the June 2011 Mayer Brown Global Corporate Insurance & Regulatory Bulletin, *Additional States Adopt Statutes Providing for Limited Purpose Subsidiary Life Insurance Companies* and our article from the December 2010 Mayer Brown Global Corporate Insurance & Regulatory Bulletin, *Iowa Limited Purpose Subsidiary Life Insurance Companies*.

US – Dodd-Frank update: CFTC approves final rules regarding swap dealers and major swap participants

On 11 January 2012, the Commodity Futures Trading Commission (**"CFTC"**) approved final regulations establishing a registration process for swap dealers and major swap participants. Registration will not become mandatory until such time as the rule defining key terms such as "swap", "swap dealer" and "major swap participant" becomes effective. The final regulation includes a provisional registration process whereby prospective swap dealers and major swap participants can become provisionally registered subject to rolling compliance with new regulations under Section 4s of the Commodity Exchange Act (**"CEA"**) as they become effective. The CFTC is delegating registration functions to the National Futures Association. Under the registration requirements, swap dealers and major swap participants must become and remain members of a registered futures association. Push-out affiliates (a non-insured depositary institution affiliate that is a swap dealer or major swap participant) will also be subject to the foregoing requirements.

The final regulations prohibit any swap dealer or major swap participant from permitting any person associated with such entity who is subject to a statutory disqualification to effect or be involved in effecting swaps on its behalf if the swap dealer or major swap participant knows, or in the exercise of reasonable care should know, of the statutory disqualification. The final regulations provide that a "statutory disqualification" for purposes of this prohibition refers to a statutory disqualification under section 8a(2) or 8a(3) of the CEA. Further, a "person associated with a swap dealer or major swap participant" for purposes of this prohibition means an associated person, defined by the final regulations to mean a natural person with respect to such swap dealer or major swap participant. The CFTC decided to limit this particular final rulemaking to the process of registration and determined that issues relating to the extraterritorial application of the swap dealer and major swap participant registration requirements were beyond the scope of the rulemaking. For further information with respect to Dodd-Frank Title VII rule compliance schedules, please click here.

US – CPSS & IOSCO issue a final report on OTC derivatives reporting and aggregation requirements

On 17 January 2012, a task force (**"Task Force"**) consisting of the Committee on Payment and Settlement Systems (**"CPSS"**) and the Technical Committee of the International Organization of Securities Commissions (**"IOSCO"**) issued a final report on OTC derivatives data reporting and aggregation requirements. This report is the most recent step taken at the initiative of the Financial Stability Board (**"FSB"**) with respect to the implementation of G20 objectives, including the requirement that all OTC derivatives contracts be reported to trade repositories (**"TRs"**) in order to improve transparency, mitigate systemic risk and protect against market abuse.

The report specifies minimum requirements for reporting data to a TR and for the reporting by a TR to regulators. The Task Force recommends that transaction-level data be reported to TRs, including transaction economics, counterparty information, underlier information, operational data and event data.

The report discusses issues related to access to data. It recommends that TRs implement measures to provide effective access to authorities for both routine data and non-routine data in order to permit authorities to fulfill their regulatory responsibilities and to address specific issues that may arise from time to time. The report recommends that reporting entities and counterparties should have access to their own data and also addresses the possibility of public dissemination of certain data as a means of promoting understanding of the functioning of the OTC markets, subject to confidentiality and other legal requirements.

The report also addresses data aggregation mechanisms and tools needed by authorities to aggregate data in a manner sufficient to fulfill their regulatory mandates. The Task Force recommends the creation of a system of legal entity identifiers (**"LEIs"**), continued international consultation regarding the implementation of LEIs and an international effort to develop an international product classification system for OTC derivatives. The Task Force further recommends that CPSS-IOSCO or FSB make a public statement calling for the timely industry-led development, in consultation with authorities, of a standard product classification system that can be used as a common framework for classifying and describing OTC derivative products and that the FSB direct further consultation and coordination by financial and data experts regarding these initiatives.

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
+44 20 3130 3285
apayne@mayerbrown.com

Learn more about our Insurance Industry Group.

Mayer Brown is a global legal services organisation 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: 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 (authorised 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.

© 2012. The Mayer Brown Practices. All rights reserved.

0328ins
January 2012