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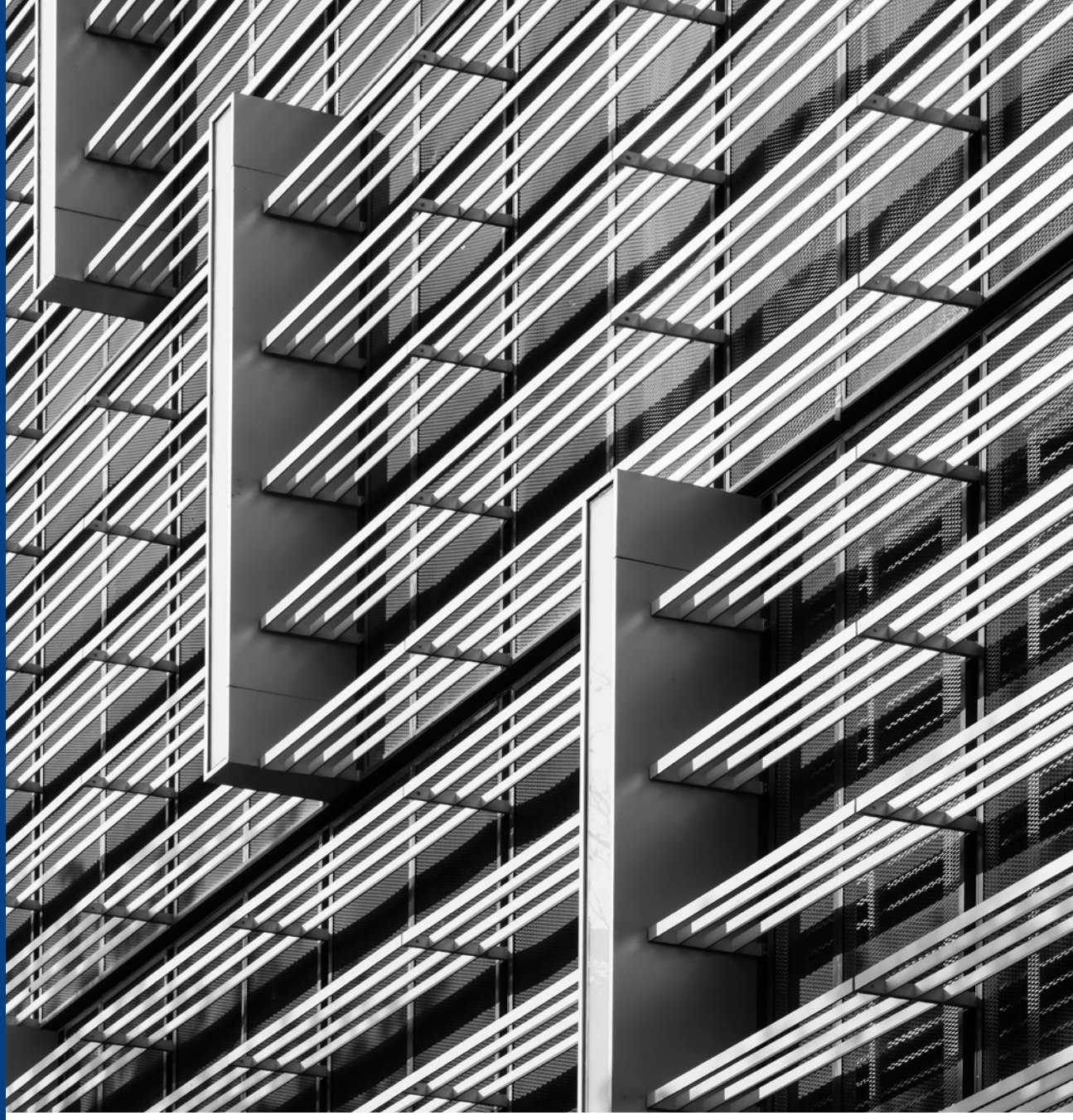

In this week's Insurance Bulletin:

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"... HM Treasury pointed out that a key objective of the UK's PCC regime was to ensure the segregation of cells within a PCC and that to allow cells to enter into contracts with each other would be contrary to this key objective. However, the government did recognise that in some circumstances arrangements between cells could be useful to market participants and has introduced provisions to facilitate such arrangements into the draft regulations."

1. REGULATION AND LEGISLATION

UK: HM Treasury responds to ILS regime consultation

As we reported in our bulletins of 8 December 2016 and 26 January 2017, in late 2016 HM Treasury published a consultation paper containing draft regulations for the Insurance Linked Securities (ILS) framework, and in January 2017 the Insurance Law Committee of the City of London Law Society published its response to the consultation. HM Treasury has recently published its own response to the consultation process.

The latest documents summarise the responses to the consultation process and then deal with the key issues raised in those responses, providing further explanation where required. HM Treasury received 19 responses to the consultation which were technical in nature and it has therefore not described each of the responses.

One of the key elements of the proposed regulations was the introduction of a protected cell company (PCC) regime, in order to ring fence the assets and liabilities of investment cells within private companies in order to comply with Solvency II. Some respondents to the consultation requested that the regulations permit arrangements between cells within a PCC on the basis that such arrangements are permitted in other jurisdictions and are commonly used in the ILS market. In its response, HM Treasury pointed out that a key objective of the UK's PCC regime was to ensure the segregation of cells within a PCC and that to allow cells to enter into contracts with each other would be contrary to this key objective. However, the government did recognise that in some circumstances arrangements between cells could be useful to market participants and has introduced provisions to facilitate such arrangements into the draft regulations. These provisions provide "gateways" for the movement of assets between cells but are subject to very strict procedural requirements.

Another example of a change made to the regulations is in response to the suggestion that directors of PCCs ought to be subject to an additional duty of care. As a result, HM Treasury has now introduced provisions into the draft regulations requiring directors to (i) exercise reasonable care, skill and diligence to ensure that a PCC complies with the Risk Transformation Regulations and (ii) act in accordance with any enforceable arrangements which are made between cells.

Further changes include:

- Agreement in principle from the government that ILS shares could be traded on secondary markets, providing that the trading venue was accessible only to qualified investors.
- Provision for a quicker procedure by which business could be transferred from a cell to another company.

The government also responded to the consultation comments on the tax treatment and authorisation/supervision of PCCs. The entire report is available here and should be read in full for a thorough understanding of the amendments to the regulations.

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2. COURT CASES AND ARBITRATION

UK: Scheme to transfer business between two insurance companies sanctioned

On 19 July 2017, the court hearing *In the Matter of Colbourne Insurance Company Ltd and In the Matter of NRG Victory Reinsurance Ltd* sanctioned a scheme to transfer the insurance and reinsurance business of an insurance company in run-off and which could not meet its capital requirements, to another insurance company that was very well

capitalised. In reaching its decision, the court considered that the scheme was unlikely to materially affect policyholders and that no objections had been received.

The applicant insurance companies had applied for an order under the Financial Services and Markets Act 2000 s. 111(1) to sanction a scheme to transfer Colbourne's insurance and reinsurance business to NRG. Colbourne's business was marine hull and cargo insurance. It had been in run-off since 1991, was technically insolvent and relied entirely on support from its ultimate parent company, which company was under no obligation to give or continue that support. NRG's business now involved handling predominantly asbestos and pollution claims. It had significant claims reserves and had been granted a variation of its permission to be able to accept Colbourne's business.

The independent expert considered that NRG would be well capitalised after as well as before the proposed scheme, and that the scheme would result in substantial improvement in the security for transferring policyholders. NRG was already involved in handling Colbourne's claims, as a member of a group that was the ultimate 100% reinsurer of another reinsurance company, and therefore claims handling service levels were unlikely to be affected. No objections were received from the FCA or PRA, and the Institute Of London Underwriters had only raised an issue about the continuance of a guarantee given by Colbourne's insolvent parent company.

The court held that provided the technical requirements were met, it was necessary to consider all the circumstances in order to decide whether or not to sanction the scheme. It was necessary for the court to consider whether the scheme was unfair to any affected policyholders, and in so doing had to determine what the contractual rights and reasonable expectations of policyholders were before the scheme and then compare them with what the position would be if the scheme was given effect. Provided that the scheme as a whole was fair, the fact that some policyholders might be adversely affected did not mean that the scheme should be rejected.

Central to the decision in this case were the two compelling reports produced by the independent expert. His views, that the proposed scheme did not give rise to any material adverse impact to the reasonable expectations, security of, contractual rights or service levels experienced by any group of policyholders, in addition to the facts that the regulators did not object, that the scheme had been fully explained to policyholders and the statutory requirements had been met, and that the scheme gave effect to a reasonable commercial objective, resulted in the sanctioning of the scheme by the court.

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3. INTERNATIONAL

Australia: Meaning of "third party claim" in a "claims made" policy

Malamit (a project manager) and its directors were insured under a claims-made professional indemnity policy, and was sued in negligence by a related company. The policy defined "claim" as particular proceedings brought by a "third party against the Insured", and excluded claims "by, on behalf of, or for the benefit of any insured, subsidiary, or family member of the insured."

A director and shareholder of Malamit was also sole director and a shareholder of the trustee of the claimant, Treetops, a unit trust. That director-shareholder and his family also held shares in the corporate unit-holders of the trust.

The insurer successfully argued at first instance that the claimant was not a "third party", as defined, and so the claim was not covered, and that the claimant was a subsidiary of the insured, and so any claim by it would be excluded.

In partially reversing this, the New South Wales Court of Appeal held[1] that the policy should be read on the basis that exclusions removed existing cover, namely if a claim is not covered, there is no need to exclude it, and so the trustee's claim against a named insured was brought by a "third party", as required. However, the third party's claim was excluded because it was brought "by" a subsidiary of the director-shareholder.

WE'RE TAKING A SHORT SUMMER BREAK AND OUR NEXT BULLETIN WILL BE PUBLISHED IN SEPTEMBER.

1 *Malamit Pty Ltd v WFI Insurance Ltd* [2017] NSWCA 162

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