

# insurance focus

insurance

december 2004

*Capturing the captives  
an assessment of the  
impact of new insurance  
regulations on Bahrain*

*also*

hurricanes and the impact of climate change

regulatory changes in China

the EC take on gender neutrality and  
insurance premiums

the imminent arrival of a new Financial  
Services Act in the Netherlands

*and*

case notes

stop press

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Our **lead article** this month focuses on recent developments in the captive market in Bahrain. October saw the publication of the “Insurance Rulebook”, the Bahrain Monetary Agency’s guide to insurance business in Bahrain. Abdullah Mutawi of our Bahrain office explains the effect of the new rules and why he anticipates that Bahrain may succeed in its wish to become the leading captive domicile in the Middle East.

In the article “**No increase please, we’re women**”, Maria Ross, a corporate finance Partner in our London office, who specialises in insurance and financial services sectors, explores the realities behind the effect of the controversial proposals in the draft European Directive on gender equality. She also explores the apparent climbdown by the European Commission. The Commission’s response is explained by the strong opposition of the UK insurance market, which was due to the effect that the new proposals would have on the pricing of insurance, particularly motor and life insurance.

The possibilities of foreign investment in the Chinese insurance market are increasing but so far average returns on investment are low. Jean-Marc Deschandol, a Partner in our Beijing office, has advised many clients on corporate and regulatory matters in the People’s Republic of China. He gives us **his insight** into some of the reasons for this underperformance and for the restrictions in place as a result of the new regulatory framework in China.

The weather has been a topical issue. The devastation resulting from recent hurricanes in the USA, the Caribbean and Japan has caused insurers and reinsurers to assess their position. Closer to home, severe flash flooding in the UK and throughout Europe has raised the collective consciousness of climate change. Bob Haken, a corporate finance associate in our London office, who specialises in insurance and reinsurance, **assesses the impact** of the current situation on the insurance industry and considers possible trends for the future.

The Netherlands is expected to implement a new Financial Services Act in 2005 which will have a broad impact on the financial services sector. The Act will particularly affect insurance intermediaries and consultants, who will require authorisation if they want to be able to continue to operate in the insurance market. This is in line with the regulatory developments which are about to take effect in the UK in January 2005. Otto Klaassen, a corporate finance lawyer in our Amsterdam office, **explains** how the Dutch Parliament intends to protect consumers when they enter into agreements for financial products.

The **case notes** in this edition look at judgments published since our August 2004 edition and dealing with the issues of construction of an all risks insurance policy and the meaning of robbery or hold-up (*Wooldridge v. Canelhas Comercio Importacao E Exportacao Ltda*), coverage issues in a marine policy related to loss of time and loss of income (*If P&C Insurance Ltd v. Silversea Cruises*), the nature of a notice clause in an insurance policy (*Friends Provident Life and Pensions Ltd. v. Sirius International Insurance Corp*) and a reinsurance judgment dealing with waiver, affirmation and non-disclosure (*WISE (Underwriting Agency) Ltd v Grupo Nacional Provincial SA*).

The other topical issue in the market in recent weeks has been the investigations of Eliot Spitzer in New York targeted against the insurance industry. It remains to be seen how the FSA will react, if at all, in regulating the London insurance market and the impact of the steps taken by Spitzer. The FSA's current position is that it has no statutory powers to investigate the allegations until 15 January 2005. There have been suggestions that the Treasury will not put pressure on the FSA to act prematurely, but it has indicated that the FSA will have a responsibility to intervene when appropriate.

It is too early to say what this will mean for the insurance industry, but for the foreseeable future the issues will remain "live" to the London market as well as in the USA.

In the meantime, may I take this early opportunity to wish you all a very happy Christmas and a prosperous New Year.

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# capturing the captives

## Bahrain and its push to win the captive market

*Bahrain's desire to become the leading captive domicile in the Middle East moves on apace, as new insurance regulations come into force. Abdullah Mutawi reviews the new regulations and assesses their impact on Bahrain.*

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### **First in the market**

### **Points of difference**

### **Reaping the rewards**

### **The impact on Bahrain**

*the potential benefits to Bahrain of establishing itself as a captive domicile are huge*

October 2004 saw the publication of the Insurance Rulebook, the Bahrain Monetary Agency's guide to insurance business in Bahrain. Industry figures are focusing on the potential for captive insurance firms in Bahrain, as the regulations attempt to lay down the ground rules for a country aiming to become the leading captive domicile in the Middle East.

The Bahrain Monetary Agency ("BMA") differentiates between captive insurers and insurance firms on the basis that a captive's obligations are to its owners, not third parties. Another distinguishing feature is that a captive's risk exposures will generally be more concentrated and, at the same time, more limited than conventional insurers (although some captives may insure liability risks). A further difference is that a captive will generally be managed by a third party insurance manager.

### **First in the market**

Clearly, the potential benefits to Bahrain of establishing itself as a captive domicile are huge and the BMA has been quick to respond to the challenge of becoming the first country within the Gulf Cooperation Council ("GCC") to create sophisticated rules for the captive market. With this in mind, the BMA published the final draft version of its rulebook for captive insurers in September 2004. These are the first guidelines and parameters regarding the captive insurance market to be published in the Middle East and are of particular importance in assessing the potential for the captive insurance market in the Middle East and North Africa.

### **Licences for new captives**

In anticipation of the new regulations, the BMA issued the first licence for a captive insurer to Gulf Finance House last year. Subsequently, in June 2004 the BMA granted a captive management licence to Ensursion, a captive management company, which will be the first company to offer captive management services to large industrial and corporate clients throughout the GCC region.

Ensurion was founded and developed by investment advisory firm Stratum WLL of Bahrain, which has worked closely with the BMA to break new ground in the sector. Stratum WLL is establishing the Bahrain-based captive manager in collaboration with International Advisory Services (IAS), the world's largest independent captive management company, and The Nottingham Company, a U.S.-based back office accounting and compliance administration firm.

### Points of difference

Whilst many of the rules in the draft regulations apply equally for insurance firms as they do for captives, there are, none the less, certain differences in the treatment of captives by the BMA.

### Authorisation

Any firm in Bahrain wishing to conduct the regulated activity of insurance must be authorised. A captive insurance firm will only be granted one of the following two permissions by the BMA:

- Category C1 Company – a Bahrain authorised insurer with a single shareholder whose business is restricted to insuring only the insurance risks (other than liability risks) of the shareholder or those of subsidiaries / associated companies
- Category C2 Company – a Bahrain authorised insurer whose business is restricted to (a) insuring only the risks of its shareholders or associated companies; and/or (b) whose business may include liability risks, subject to the BMA being satisfied that the activity, capital structure and management provide sufficient protection to potential third party claimants.

*any firm in Bahrain wishing to conduct the regulated activity of insurance must be authorised*



### Principles of business include

- integrity
- objectivity
- due skill and care
- confidentiality
- market conduct
- co-operation with the regulators
- effective systems and controls



*Takaful is based on the Shari'ah concept of Ta'awum (mutual assistance)*

A captive may be licensed as a direct insurer or may restrict its business to reinsurance only. In addition, a captive insurer may be licensed as a *Takaful* insurer. *Takaful* is broadly similar to conventional mutual insurance in that it involves a number of participants sharing risk on a cooperative basis. Most Islamic scholars agree that *Takaful*, which is based on the *Shari'ah* concept of *Ta'awum* (mutual assistance), is fully consistent with *Shari'ah* law.

### Principles of business

The ten "Principles of business" that apply to all insurance firms also apply to captive insurers. The principles include obligations as to standards of integrity, objectivity, due skill and care, confidentiality, market conduct, assets of customers, co-operation with the regulators, maintaining adequate resources and ensuring there are effective systems and controls.

### Capital and solvency

Recognising that a captive's risk exposure is limited to its owning group rather than third parties, the BMA's requirements as to capital and solvency levels are lower for captives than for other categories of insurers.

### Risk management

Captive firms are subject to the same risk management requirements as other insurance firms. The BMA has granted captive insurance firms an exemption from the specific requirement of stress and scenario testing in order to test the resilience of their financial resources to specific areas of significant risk.

*a captive provides owners with direct access to reinsurance*

*there could be the equivalent of US\$ 300 million total captive insurance premiums within the GCC over the next decade*

*The new framework has consolidated Bahrain's position as the pre-eminent insurance jurisdiction in the Middle East*

## Reaping the rewards

There are considerable advantages to using a captive.

### Lower insurance costs

Ownership of a captive is likely to cost the owner less than conventional insurance and reinsurance products. This results from a captive providing owners with direct access to reinsurance, enabling them to obtain coverage at more advantageous rates than the "retail premiums" offered by commercial insurers.

Captives may also employ a lower cost structure than commercial insurers, which need to price their premiums in order to account for the costs of claims and all associated overheads, marketing expenses and profit margins. In addition, a captive may tailor the insurance premiums specifically to reflect the loss experience of the owners, rather than on an industry-wide or multi-regional basis.

### Greater flexibility

Captives can provide the flexibility of extending insurance coverage beyond that normally offered to a third party insurer. This is useful if, for example, a company is interested in extending its coverage to include new forms of insurance within certain markets and industries.

### Potential returns

Captives allow their owners to retain the investment premiums that would otherwise have gone to commercial insurers, further enabling them to increase the capacity of the insurance they provide. Leading market figures in Bahrain are suggesting that there could be the equivalent of US\$ 300 million total captive insurance premiums within the GCC over the next decade.

## The impact on Bahrain

The new insurance regulatory framework has consolidated Bahrain's position as the pre-eminent insurance jurisdiction in the Middle East region and should attract global interest in the insurance market. Its particular focus on the captive insurance and *Takaful* markets and the establishment of regional and global leaders in these respective sectors sets new standards in the region. It is generally expected that it will result in significant advances and growth in both fields in the year ahead. This will, in turn, have a significant impact on traditional premium flow trends in the region.



# what's going to happen the day after tomorrow?

climate change and the insurance industry

*Bob Haken examines the impact of the current situation with climate change on the insurance industry and considers possible trends for the future.*

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## Anticipated losses

### Future trends

*the devastation has raised the collective consciousness of climate change*



For once it's not just the English talking about the weather. The devastation caused by the recent hurricanes in the USA, the Caribbean and Japan, along with severe flash flooding in the UK and throughout Europe (not to mention the spotlight cast by Hollywood's big budget special effects) has raised the collective consciousness of climate change.

## Anticipated losses

As a result of recent events, property/casualty insurers may face losses of up to one year's earnings according to Thomas Upton, an analyst at Standard & Poor's. The aftermath of hurricanes Charley, Frances, Ivan and Jeanne and of typhoons Songda, Chaba and Megi in Japan has seen a host of major insurers announcing their anticipated losses. Industry expectations for each of Charley and Jeanne are in the region of \$6 to \$8 billion of insured loss while Frances is expected to cost \$4 to \$6 billion. Despite this, relatively few carriers are admitting to a negative impact on their financial strength. It seems as though the risks have been spread sufficiently

## what's going to happen the day after tomorrow?

*downgrades as a result of the storms would be the exception rather than the rule*

widely to absorb the cost. Standard & Poor's agrees, commenting that downgrades as a result of the storms would be the exception rather than the rule. Great news for the future, but there are still challenges to be faced in the short term.

The relatively narrow geographic scope of the storms may have limited the areas affected, but there will still be a vast number of claims to manage, often with multiple claims on single addresses. Properties that were damaged by Frances were left more vulnerable for Jeanne, inflating the economic cost of the later hurricane. There may also be pressure from regulators to reduce the high excesses currently placed on homeowner policies.

*the brunt will fall on primary insurers*

The accumulation of several major incidents rather than a single event of cataclysmic proportions means that the brunt will fall on primary insurers, who will have to meet all claims up to the attachment point on their reinsurance for each event. Added to this will be the premium payable for reinstatement, although many policy wordings only provide for a single reinstatement. The choice then is to purchase new cover or to try to ride out the rest of the season with no reinsurance. As a result, it can be expected that insurers will demand more from their reinsurance programmes in the future. One possibility is industry loss warranty cover, which pays out when the aggregated industry loss reaches a pre-set level. According to research from Helvetia Patria Group and Tropical Storm Risk, basing your decision on whether or not to purchase ILW cover on seasonal hurricane forecasting can result in achieving the same cover for up to 30 per cent less premium, while sellers can improve their net revenue by the same margin.

### Future trends

*some scientific studies predict that the economic losses from natural catastrophes will double every ten years*

With some scientific studies predicting that the economic losses from natural catastrophes will double every ten years, and others claiming that insured losses have increased tenfold since the 1960s, it is no surprise that insurers and reinsurers are looking seriously at trends in the weather. In a speech given last year in New York, Lord Levene, chairman of Lloyd's, warned of the increasing cost of natural



*over 400,000 houses have a greater than 1 in 75 chance of flooding*

*A larger, more affluent population can also exacerbate the problem*

*Insurers will look to climate modelling and complex reinsurance programmes to protect them in the future.*

catastrophes. There are various agencies that market sophisticated modelling systems, with some, such as in the Czech Republic, even offering a resolution of 10 square metres. These are generally based on three factors: the hazard, the engineering of the structures, and loss estimation. The maps compiled by the Environment Agency in the UK suggest that over 400,000 houses have a greater than 1 in 75 chance of flooding, and therefore are not automatically eligible for insurance under an industry-wide agreement. More detailed maps may reduce this number, as insurers are better able to assess the risk on an individual property rather than an entire area. There have also been calls for a claims database for windstorm damage in the UK, as a move to improving construction standards and insurance pricing.

### Socio-economic factors

But it is not just the incidence and severity of the weather conditions that have created greater losses. Socio-economic factors also contribute to the problem. Increasing prosperity means that each claim has a higher value, while the continuing shift towards living in coastal or river areas concentrates residents in areas of high risk. If Charley had not changed direction before reaching land, it would have hit Tampa, resulting in a much higher death toll and economic cost. A larger, more affluent population can also exacerbate the problem, as a more built-up area means that rainfall can no longer soak gradually into the soil but is instead diverted into high speed run-off channels. In the UK, the effects of this were seen most recently in Boscastle, Cornwall, where unusually high rainfall swept cars from the banks of the river, creating artificial dams and worsening the flooding.

### Aggregation of losses

One issue that can arise from prolonged periods of heavy rainfall relates to the aggregation of losses. The market standard wording for physical damage excess of loss policies (LPO98a) defines loss occurrence as all individual losses arising out of and directly occasioned by one catastrophe, but limits the event to 72 consecutive hours for a hurricane, typhoon, windstorm, rainstorm, hailstorm or tornado (or various non-weather related events) and 168 consecutive hours for other losses, although this wording is not used universally and has been subject to some criticism. Nevertheless, the difference between heavy persistent rain (which gives rise to the 168 hour aggregation) and a rainstorm can be important in deciding how many events there have been and therefore how many unreinsured excesses will fall to the insurer. This issue was considered by the courts in 1966 and "rainstorm" was held to connote violent wind accompanied by rain, hail or snow. It follows therefore that flood losses arising over a week-long period caused by heavy persistent rain may only be subject to one excess.

As any meteorologist will tell you, predicting the weather is not easy. Comprehensive records have only existed for a relatively short time, whereas climate cycles can stretch over centuries. For now, what is clear is that climate forecasting is becoming increasingly important to good risk management. Insurers have been able to absorb the losses to date but will look to climate modelling and complex reinsurance programmes to protect them in the future. While major rate increases are not being predicted, it seems likely that there will be some hardening of the market, while underwriting discipline remains as important as ever.



## room for manoeuvre

good news for foreign insurers in China?

*Jean-Marc Deschandol examines what the gradual relaxation of restrictions on insurers in China means for investment growth in future years. He looks, in particular, at the new foreign currency business regulations that now permit qualified insurers to invest their foreign exchange earnings overseas.*

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### Auspicious change in 2004

#### Provisional measures

#### Hollow concession?

At the end of 2003, premium income for insurance companies was almost RMB1 trillion and foreign exchange holdings exceeded USD8 billion. Yet insurers in China reported an average return on investment in 2002 of just a little over 3 per cent. Why this underperformance?

The reason is due partly to the regulatory framework within which insurers in China have had – until now – to operate. Current regulations limit insurers to investing in a narrow class of low risk, low return investments – such as bank deposits, treasuries and selected corporate bonds and mutual funds. There are, however, growing signs that the China Insurance Regulatory Commission (“CIRC”) may be willing to expand the scope of permitted investments. Does this mean a raft of new opportunities for investors in this part of the world?



**Foreign asset managers must**

- be qualified to engage in asset management business in their own jurisdiction
- use management systems that comply with the requirements in their own jurisdiction
- have a total capitalisation exceeding USD60 million and assets under management exceeding USD50 billion
- have ten years' international experience in asset management business
- provide a written undertaking that they will provide transactional information regarding the insurer to the CIRC
- operate in a financial system that has a sound securities and regulatory system and where the market regulator has entered into a memorandum of understanding with Chinese market regulators.

*very few foreign insurers can satisfy these requirements*



## Auspicious change in 2004

In April 2004, the CIRC introduced the Administration of Insurance Asset Management Companies Tentative Provisions ("AMC Regulations").

[We commented on the AMC Regulations in the last edition of *Insurance focus – ed.*]

### AMC Regulations

The AMC Regulations allow qualified insurance companies to establish asset management companies. To qualify, insurers must have minimum assets exceeding RMB5 billion (in the case of property insurers) and RMB10 billion (in the case of life insurers). Very few foreign insurers can satisfy these requirements and so will either continue to manage their assets through in-house departments or will need to team up with large local insurers to establish asset management companies.

### Risk management guidelines

In late April 2004, the CIRC introduced the Risk Control Guidelines for Use of Insurance Funds (Trial Implementation) ("Risk Management Guidelines"). The Risk Management Guidelines set basic risk control standards and corporate governance structures that all insurers must implement. The CIRC intends that the Risk Control Guidelines will operate in tandem with the gradual relaxation of the investment framework, so that insurers will only be permitted to broaden the scope of their investment portfolio if they comply with the Risk Management Guidelines. This is the case with the new Provisional Measures discussed below, which require insurers to comply with the Risk Management Guidelines in order to be eligible to invest overseas.



*most of the foreign exchange earnings generated by insurers in China has traditionally been invested in bank deposits*

## Provisional measures

As strange as it may seem, most of the foreign exchange earnings generated by insurers in China has traditionally been invested in bank deposits. Insurers have been limited both by the narrow range of permitted investments and the lack of foreign exchange investment products on the Chinese market. In August of this year, the CIRC and the People's Bank of China jointly issued the Overseas Use of Insurance Foreign Exchange Funds Administrative Tentative Provisions ("Provisional Measures") which allow qualified insurance companies to invest their foreign currency earnings overseas.

### **Making the grade**

The Provisional Regulations provide that both foreign and local insurers can apply for a permit to invest their foreign exchange earnings overseas. To qualify, an insurer must:

- have a permit from the State Administration of Foreign Exchange ("SAFE") to engage in foreign exchange business
- have total assets exceeding RMB5 billion (USD600 million) and foreign currency assets exceeding USD15 million
- comply with Chinese solvency requirements
- have a specialist asset management department or asset management company to manage funds
- comply with the Risk Management Guidelines
- employ fund management personnel that comply with CIRC requirements
- comply with any other requirements of the CIRC.

### *the Provisional Measures set high minimum asset requirements*

Like the AMC Regulations, the Provisional Measures set high minimum asset requirements. Only the largest local Chinese insurers – companies such as PICC, Ping An Insurance Company and China Life – will be able to take advantage of these concessions and invest their foreign exchange overseas. Few, if any, foreign insurers will have sufficient assets in China to satisfy the requirements, so they will continue to be restricted to investing their considerable foreign exchange earnings in the low return investments permitted by the CIRC.

### *the overriding emphasis is still on minimising risk*

#### **Reviewing the options**

Qualified insurers are permitted to invest up to 80 per cent of their total foreign currency earnings overseas. The range of permitted investments is narrow and the overriding emphasis is still on minimising risk. Permitted investments include:

- bank deposits or bank notes in overseas Chinese banks or banks that have a grade A credit rating
- foreign government, financial institution or company bonds that have a grade A credit rating
- bonds issued by the Chinese government or Chinese companies overseas
- certain other money market products, such as bank bills and negotiable deposit receipts with a grade AAA credit rating
- other investments permitted by the State Council.

#### **Engaging foreign asset managers**

Insurers must engage a custodian in China to manage the funds and may also engage a qualified foreign asset manager to manage the assets overseas. This should create new opportunities for foreign asset managers, as it has been estimated that the Provisional Measures will unlock around USD6 billion in insurance foreign exchange funds that could be invested overseas.

## Hollow concession?

The pressure to broaden the scope of permitted investments has come from a number of directions. Insurers are anxious to see improved returns, the China Securities Regulatory Commission hopes to see insurance funds invested directly in China's depressed stock markets and shareholders of Chinese insurers are anxious to see a more competitive return on their investments.

### *it is unlikely that any foreign insurers will qualify*

The AMC Regulations and the Risk Management Guidelines set the foundations for further expansion of the scope of permitted investments, and the Provisional Measures represent some of the first steps to relax these restrictions. For foreign insurers, however, the Provisional Measures are a hollow concession, as it is unlikely that any foreign insurers will qualify to take advantage of the new laws in the foreseeable future.



# no increase please, we're women

the EC drive on gender neutrality

*Is pricing according to sex discriminatory? Maria Ross maps out the way forward for motor insurance for men and women, in an article previously published in The Times (19 October 2004).*

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There was bad news for boy racers and good news for careful women drivers last week, as the European Commission abandoned plans to prohibit the perceived sex discrimination of insurance companies that offer differential motor insurance premiums based on the gender of the driver.

*one of the last battles in the war on sex discrimination has been lost*

One of the last battles in the war on sex discrimination – the right to require women drivers to pay equivalent premiums to men for motor policies – has been lost for the moment at least. Controversial proposals to outlaw insurers using gender as a factor in pricing insurance have been fiercely opposed by the industry, which has argued that Brussels was blindly ignoring the delicate science of underwriting. The use of sex-based actuarial factors for insurance premiums has been possible in the UK under an exception to the Sex Discrimination Act.

## no increase please, we're women

*the Directive could have meant the end of the road for specialist car insurance companies in Britain*

The European Commission proposals, contained in its Directive on gender equality, would have forced insurance companies to apply "gender neutrality" to their insurance premiums and not to have relied on statistical evidence pointing to differences in risk between men and women, based on driving experience, life expectancy and other factors commonly applied to calculate premium rates. The Directive would have affected life policies, where women typically receive smaller annual annuities owing to longer life expectancy. Under the Directive, women's life insurance premiums would have increased. More seriously, it could have meant the end of the road for specialist car insurance companies in Britain which only deal with women and offer correspondingly lower rates. Diamond, the specialist motor insurer for women, predicted that this politically correct reform could see women drivers' premiums shoot up by as much as 40 per cent, whilst young men could expect to pay up to 20 per cent less. However, after last week's apparent climb-down by the European Commission, insurers such as Diamond will now have to justify their methods under the new EU sex discrimination law, and explain discriminatory pricing policies to the industry, anti-discrimination bodies and member states. "If they don't come up with a satisfactory explanation to us and their customers, then we'll come back with a tougher proposal," an EC spokesman told the press. He said that it was now up to the industry to explain why they thought sex was "the determining factor".

*Brussels is missing the point*

*underwriting is a skilled exercise and a "one size fits all" approach is just not appropriate*

But Brussels is missing the point. Nobody would argue that sexual discrimination should be banned in the work place and other areas of life where gender has no relevance. But motor insurance premium levels are determined after a considered calculation of risk, based on actuarial statistics, of which gender is an important determinant. Underwriting is a skilled exercise and a "one size fits all" approach is just not appropriate.



## no increase please, we're women

*according to the Home Office, men commit 85 per cent of all serious motoring offences*

According to the Home Office, men commit 85 per cent of all serious motoring offences. "Women, in particular young women, are a substantially different risk to men or, to put it in laymen's terms, they are simply better drivers," argues David Stevens, the underwriting manager at the Admiral Group, which owns Diamond. But is pricing according to sex discriminatory? No, he replies. "It should be illegal to discriminate on the basis of sex, but it should be legal to price on a basis of objectively demonstrable risk difference," he argues. "The fact that women motorists have different driving characteristics to men should be reflected in pricing."

*insurers welcomed the sceptical stance taken by peers*

Last month insurers welcomed the sceptical stance taken by peers when a House of Lords committee looked at the Directive. Lord Williamson of Horton, chairman of the inquiry, said it was "practical and sensible" for the UK to keep its current system. "You have to weigh the case of principle against practicality," he said. "In time, gender can and should be taken out of most calculations for car insurance premiums," the committee found. "But when companies set premiums for new drivers with no track record, gender matters."

*the FSA also took issue with the EC*

The FSA also took issue with the EC earlier in the year. "It is a concern whether the wholly laudable aim of preventing gender discrimination can be practically achieved by a statement which overrides realities and, second, whether the implications of what has been proposed have been thought through," said FSA chairman Callum McCarthy.

The resistance from insurers is not just based on arguments of self-interest. There may be serious road safety consequences from abandoning gender-based risk rating. For example, in Canada some provinces allow insurers to use gender and age when setting premiums, whilst other "regulated" provinces have effectively banned the practice. Perhaps it is sheer coincidence, but deaths on the road are almost 20 per cent higher in those regulated provinces.

A final thought: according to one leading insurer, the average premium cost for an 18-year old male driving a Vauxhall Astra is £1,619, which is £600 more than his female equivalent would have to pay. Cheaper insurance would have meant more cash in the pocket for boy racers. They would have been driving bigger and faster cars, which could well have meant more deaths on our roads. This volte face by Brussels is to be welcomed.



## a safe harbour in sight

protection for Dutch consumers under the new Financial Services Act

*The Dutch financial services sector will have to face added costs once the Financial Services Act comes into force in 2005. Otto Klaassen looks at what this means for insurance companies and intermediaries and for Dutch consumers.*

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### Rules of conduct

#### Impact on the sector

*insurance intermediaries will now be required to go out and obtain a licence.*

The Dutch parliament is currently reviewing the final draft of a new Financial Services Act (Wet financiële dienstverlening; the "Act") that is expected to come into force in mid-2005. The Act is part of the Dutch government's attempt to protect consumers when they enter into agreements for financial products. The Act applies across the financial services sector and implements, amongst others, the Insurance Intermediaries Directive and the Financial Directive on the Distance Marketing of Consumer Financial Services.

The Act comes at a time when the focus in the Netherlands is shifting towards consumer protection in relation to financial products. This follows a few high-risk financial products, such as the "share-lease products" where people borrow money in order to invest in shares, which have resulted in disputes between consumers and the banks that offered these products. The Dutch government has therefore decided to push this Act forward to meet the perceived need for greater regulation.

The Act requires that all financial services providers obtain a licence from the Authority of the Financial Markets ("AFM"), the regulator of the financial markets, together with an associated test of expertise and reliability. Banks and insurance companies will receive a licence by operation of law as they are already regulated by other Acts. The licensing requirement will therefore have a greater impact on insurance intermediaries and consultants, as they will now be required to go out and obtain a licence.

### Rules of conduct

As well as the licensing requirement, the Act also contains certain rules of conduct. For example, the Act imposes an obligation to provide certain information, both before and at the end of the relevant contract. This includes any marketing relating to the product, and any information about the provider of the services (such as whether they are independent and whether they are paid on a commission basis). The Act also contains know-your-customer obligations for consultancy services and an obligation to deal appropriately with complaints. The detailed rules will be set out in statutory instruments, which are still being prepared by the Ministry of Finance.

**The Act applies to any provider of a financial project. This includes:**

- the offering of products by suppliers, such as insurance companies and banks
- the mediation of products by agents, such as insurance intermediaries
- consultants advising consumers on financial products.

*small intermediaries will be unable to bear the administrative costs*

## Sanctions

The enforcement of this Act will be handed to the AFM, who will have the power to impose sanctions on companies if it finds that a law or rule has been broken. These sanctions (which may also be published) include the issue of an instruction or a public warning; withdrawal of permits; and the imposition of fines and periodic penalty payments.

## Impact on the sector

The implementation and compliance with the certification and documentation requirements will be expensive for the Dutch financial services industry.

These additional financial and administrative requirements will probably lead to increased consolidation in the Dutch market, as small intermediaries will be unable to bear the administrative costs associated with compliance.

## Case Notes

### Wooldridge v Canelhas Comercio Importacao E Exportacao Ltda [2004] EWCA Civ 984

#### Court of Appeal – Thorpe LJ, Mance LJ and Munby J 26 July 2004

##### *Construction of insurance policy – “holdup or robbery” limit*

The appellant was an underwriter, representing a Lloyd’s syndicate, and was appealing against a decision on an application for summary judgment. The insurer relied on a special condition in a policy held by the assured, and the appeal focused on the construction of that condition.

The assured was a jeweller in São Paulo. In December 2000 the claimant’s managing director (Mr Canelhas) and his family were kidnapped by six men who ordered Mr Canelhas to go to the office of the jewellers, empty the safe of its gems and hand the gems over to the kidnappers in exchange for his son. The assured then made a claim under its insurance. The insurer resisted payment, claiming that a special condition (the “Holdup or Robbery Limit”) contained in the policy applied. This special condition stated that:

“Underwriters’ liability under Item 1 of the Schedule in respect of loss or damage to property by Robbery when the premises are open for business or when the assured or any of their employees (other than security personnel) are present at or in attendance at, the premises shall not exceed : – Nil”.

Item 1 of the Schedule applied to the stock and merchandise.

The insurer applied for summary judgment in reliance on this special condition. The judge at the summary judgment application held that the special condition did not apply, and the Court of Appeal agreed. The court looked at the commercial application of the condition, and how an ordinary reasonable commercial man would interpret it within the language and standard wording of the policy.

The policy was essentially an “all risks” policy, and the special conditions were there to restrict the general cover in specific circumstances. To trigger this particular condition, three factors must be present: (1) there must be loss or damage to property, (2) there must be robbery and (3) the robbery must be at a time when the claimant’s premises were open for business or the claimant or any of its employees were present. The judge held that it would be inappropriate to delve into the meaning of the word “robbery” (under either the English or the Brazilian legal system). His view was that the policy was referring to “theft accompanied by an element of immediate violence”.

When reading the clause, it is clear that it was intended to cover a case where the victims of the violence would be the officers or employees of the company, and that this violence would take place on the premises (this being the general perception of a “holdup”). It was not aimed at the case in point, where the violence and threats took place away from the premises, with the officer or employee being put under duress to take the merchandise at a later time. The appeal was dismissed.

## **If P&C Insurance Ltd v Silversea Cruises Ltd & ors [2004] EWCA Civ 769**

### **Court of Appeal – Mummery LJ, Rix LJ and Ward LJ 2 July 2004**

#### ***Shipping – coverage issues, loss of time, loss of income***

The assured, Silversea Cruises Ltd (“Silversea”), appealed against the dismissal of claims under a policy of insurance. Silversea owned four luxury cruise ships, which were insured by If P&C Insurance Limited (“P&C”) by way of a “loss of income and extraordinary costs” policy. The policy covered three separate types of cover: Ai – loss of income, Aii – loss of anticipated income, and B – cover for compensating passengers by issuing cruise credits.

Following the terrorist attacks of 11 September 2001, Silversea suffered falling passenger numbers and made a claim on the policy. At first instance, the judge dismissed Silversea’s claims under Ai and B, but allowed the claim in respect of Aii. The judge also deemed the limit in that cover to be US\$5 million in total, rather than per vessel. On appeal the issues were therefore whether (1) Silversea had any claim under covers Ai and B, and (2) the limit of \$5 million under Aii was per vessel or across the whole fleet.

The court looked at the difference in the way that covers Ai and B worked in contrast to Aii. Ai and B applied when the actual operation of the vessel was disrupted, and compensation was to be calculated according to loss of time or the cost of compensating passengers. The loss of income must be due to one of a number of events (including acts of war or by terrorists) which “directly interferes with the itinerary of the insured vessel”. In this case, the loss of income was the result of passenger cancellations following 9/11; the itineraries of the vessels were not affected. Any cancellations of scheduled cruises resulted from lack of demand rather than reasons of safety. The cover under Ai was not designed to cover loss of a market. This was the province of Aii cover, which covered “anticipated income”. Although there could be cases of overlap between the different covers, there was no such overlap in this case.

As to the \$5 million limit under the Aii cover, this was expressed in the policy as “in annual aggregate and in all”. Silversea argued that the limit applied to each vessel separately, relying on the fact that the policy expressed “Each vessel to be a Separate Insurance”. P&C however, relied on the fact that the premium was paid on the fleet as a whole rather than per vessel. The judge held that the wording “in annual aggregate and in all” could only mean that the limit was intended to be fleet-wide.

## Friends Provident Life and Pensions Ltd v Sirius International Insurance Corp and others [2004] EWCH 1799 (July 2004)

This case considered the nature of a notice clause in an excess layer wording of a professional indemnity insurance policy and whether it should be considered in the same way as an innominate term. The Claimants purchased London & Manchester Assurance Co Ltd (“LMA”) which was insured by the Defendants from Feb 1993 to Jan 1994. The insurance was arranged in two layers; a primary layer and excess and the Defendants were excess underwriters. LMA were in the business of giving pensions advice to individuals and as a result of the SIB pension miss-selling review, LMA were required to pay in excess of £5m in compensation.

A general condition in the primary policy, described as a condition precedent, required LMA to notify the underwriters as soon as possible of any circumstances that might give rise to a claim and that, in the event that claims were made after the end of the policy period but which arose out of circumstances notified within the policy period, those claims would be covered.

The excess layer policy was based upon the standard wording in LPO 333 and incorporated the terms and conditions of the primary policy but also contained express conditions of its own, including a notice provision which required notice to be provided to the excess layer underwriters at such a time as LMA became aware the claims were likely to exceed the primary layer.

LMA claimed that notice had been sent by letter addressed to Lloyd's underwriters through the brokers in January 1994. In fact, the letter never reached the Defendants and no claims were made during the policy period.

LMA argued that the notice provided to the brokers was sufficient to bind the excess layer underwriters, either because notice to the primary layer was sufficient or because the broker was the agent of the excess layer underwriters.

The Defendants argued that the general condition in the primary policy was not incorporated into the excess layer policy by the general words of incorporation and that the excess policy only provided cover for claims actually arising during the policy period irrespective of the notification of circumstances. Alternatively, the Defendants argued that if the general condition was incorporated, it required that notice be provided to the excess layer underwriters within the policy period as a condition precedent to liability and that this had not been satisfied by the letter to the brokers. Finally, the Defendants argued that the notice clause of the excess layer policy was a condition precedent.

The Commercial Court held that cover provided by the excess policies did extend to claims arising out of circumstances notified during the policy period, but that notice to the brokers was not sufficient to constitute notice to the Defendants. However, the court held that when a general condition was incorporated into the excess layer, it

had the effect that notice to the primary layer of circumstances likely to give rise to a claim was sufficient to bind excess layer underwriters and that the letter to the brokers had been sufficient for this purpose. The Court held that the assured was under an additional obligation to give notice to the excess layer underwriters at such time as LMA became aware that claims were likely to exceed the primary layer. The court held that this obligation was an innominate term, a sufficiently serious breach of which would entitle the Defendants to reject liability for the relevant claim. Norton Rose acted for the defendants.

## **WISE (Underwriting Agency) Ltd v Grupo Nacional Provincial SA [2004] EWCA Civ 962**

**Court of Appeal – Peter Gibson LJ, Rix LJ, Longmore LJ**

**20 July 2004**

### ***Reinsurance – waiver, affirmation and non-disclosure***

This was an appeal by a Mexican underwriter (Grupo) against a decision that a reinsurer (WISE) was entitled to avoid a reinsurance contract.

Grupo insured a company (P) which sold luxury goods in Miami and Cancun. WISE then reinsured Grupo. The reinsurance covered transport between Miami and Cancun. The slip presentation had been prepared in Spanish and referred to Rolex watches. However, when the presentation had been translated into English, the watches were accidentally referred to as clocks. When a container of goods was stolen, P made a claim for \$800,000, of which \$700,000 related to Rolex watches. WISE sought to avoid the reinsurance on the basis of misrepresentation and non-disclosure. Grupo raised a defence that WISE had waived any disclosure, and had affirmed the contract by giving notice of cancellation whilst having notice of the grounds for avoidance. WISE denied having given notice of cancellation. At first instance the judge found that WISE was entitled to avoid the contract as Grupo had failed to disclose the shipment of Rolex watches and that this failure had induced entry into the contract. The judge also found that the disclosure had not been waived, and that the contract had not been affirmed. The insurer appealed and was successful for the following reasons:

- The following test for waiver was applied:
  - (a) was there a fair presentation of the risk?
  - (b) was the insurer put on enquiry by the disclosure of facts that would raise in the mind of the reasonable insurer at least the suspicion that there were other circumstances which might vitiate the presentation?

The fact that high value goods would be transported was a material fact and should have been disclosed. Therefore, the presentation was not a fair presentation. Furthermore, the fact that the word “clocks” was used to describe

the goods was not something that would raise suspicion in the mind of a reasonable insurer. Although a more alert underwriter could have elicited by focused enquiry the fact that high value brand name watches were being transported, this was not sufficient to establish waiver.

- The court agreed with the decision of the judge at first instance, who found that, if WISE had been informed that high value watches would be shipped from Miami to Cancun, it would not have agreed to the insurance. The non-disclosure had therefore induced entry into the contract.
- On the basis of the witness evidence, the court found that WISE had given oral notice of cancellation at a time when it was aware of the grounds for avoidance, and this was evidenced in an email sent by the placing broker to the reinsured. WISE had therefore affirmed the contract.

## Stop press

### Three Rivers District Council and Others v. Governor and Company of the Bank of England [2004] UKHL 48

The House of Lords has overturned a Court of Appeal decision concerning the meaning of “legal advice” privilege.

The key issue was whether solicitors’ advice to clients was covered by legal privilege when it was given in the context of advice as to how evidence should be presented to an enquiry and how to limit reputational risk as opposed to giving advice in the context of legal proceedings which were in contemplation or pending.

Advice given in the latter category has always been protected by litigation privilege and such advice remains completely confidential between client and his solicitor.

As a result of the Three Rivers litigation there has been a huge debate over where the boundaries lie when considering the legal privilege protection afforded to clients who take advice from their solicitors in non-contentious matters.

The Three Rivers case concerned litigation between the liquidators of the Bank of Commerce and Credit International (“BCCI”) and the Bank of England (“the Bank”). The collapse of BCCI resulted in an enquiry into the Bank’s regulation of BCCI chaired by Lord Bingham in 1992 and the liquidators wanted to obtain disclosure of some of the documents prepared by the Bank’s employees related to its submissions to the enquiry. The Bank argued that the documents were protected by legal advice privilege as opposed to litigation advice privilege.

The Court of Appeal held that legal advice privilege was confined to advice on legal rights and obligations only and did not extend to matters relating to the presentation of evidence to the enquiry and how to limit reputational risk. Contrary to this position, the House of Lords found that “It is in the interests of the whole community that lawyers give their clients sound advice, accurate as to the law and sensible as to their conduct”.

Clients and their lawyers should take great comfort from these words; solicitors may advise their clients not only as to the letter of the law and their rights and obligations under it but can also extend their advice to what they should prudently and sensibly do to protect their position in the relevant legal context when advising on non-contentious matters, without fear that such advice will be disclosable in subsequent legal proceedings or regulatory enquiries.

One issue from the Court of Appeal’s ruling which the Lords did not address was the definition of “client”. The Appeal Court decided that the “client” was three Bank employees who were responsible for coordinating the preparation of the submissions for the enquiry. This means that only communications between the Bank and these three individuals would be protected by legal advice privilege.

The judgment gives food for thought particularly to in-house lawyers who must be even more aware of when they are giving and receiving legal advice and when they advise in a commercial capacity.

The full judgment can be reviewed by clicking

<http://www.publications.parliament.uk/pa/ld200304/ldjudgmt/jd041111/riv-1.htm>

### **iNsight to insurance trends**

The Norton Rose insurance group has recently launched a new addition to their website called “iNsight to insurance trends”. The iNsight focuses on recent changes in the insurance market and in particular four themes which are currently of concern for many insurance companies – capital, outsourcing, regulation and distribution (CORD). It also features comments from our insurance experts on new developments in the market and an update on our recent news, publications and forthcoming events.

Please click on this link [www.nortonrose.com/insurancetrends](http://www.nortonrose.com/insurancetrends) for more information on our insurance iNsight.

## insurance focus

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