

INSURANCE AND REINSURANCE

# NewsWire

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## There is no such thing as a free lunch

### The Bribery Act 2010: added perils for the insurance industry

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Extra-territorial in its application and aggressive and wide-ranging in its scope, the U.K. is introducing a new Bribery Act (the “Act”) designed to haul antiquated English law bribery and corruption offences into the modern era.

The new law represents a radical departure from prior practice, and as a result, presents significant challenges to corporations and individuals alike. The Act is being introduced against a background of increased international co-operation and almost unprecedented activity by U.K. regulatory authorities frustrated by the weakness of the existing legal regime. The Financial Services Authority (the “FSA”) has as one of its statutory objectives the obligation to prevent financial crime, a subject to which it has devoted considerable time and resources in recent years.

In a recent insurance industry example, Aon, the global insurance broker, was fined £5.25 million in 2009 for failing to take reasonable care to establish and maintain effective “systems and controls” to counter the risks of bribery and corruption associated with making US\$7 million of payments to overseas firms.

Aon’s problems stemmed from the activities of a company it acquired. It is noteworthy, however, that Aon was fined not for breaches of a specific anti-bribery law, but for failing to maintain adequate systems and controls over its business, in breach of its obligations under the Financial Services and Markets Act 2000.

Regulatory intervention of this type creates the potential for double jeopardy for entities such as insurance companies, banks, investment houses and brokers — all regulated by the FSA — as they are exposed to regulatory action and penalties, as well as criminal sanction by prosecuting authorities enforcing the Act. Further, and in contrast to the prosecution of offences under the Act, however, the FSA does not need to satisfy the criminal burden of proof of “beyond a reasonable doubt”. */ continued on page 2*

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## The Bribery Act 2010

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### Overview of the Act

The key features of the Act are:

- **Its extra-territorial effect.** It has serious implications not only for U.K. citizens and companies, but also for foreign companies, their employees and agents, joint venture partners and consortia which do business with, in or from the U.K.
- **The introduction of a specific “Corporate Offence” of failing to prevent bribery.** Strict liability applies to an organisation which fails to prevent bribery and corruption by those performing services on its behalf, including its employees, agents, business partners and even its subsidiaries.
- **An obligation to put in place “adequate procedures” to pre-**

- **Widened prosecution channels.** The decision to prosecute the new offences will lie with a wider range of public officials than was previously the case: the Director of Public Prosecutions, the Director of the Serious Fraud Office or the Director of the Revenue and Customs Prosecutions Office.

### What are the new offences under the Act?

The Act replaces the existing law with four related crimes — two “general” offences and two “discrete” offences — which criminalise the following activities:

#### General offences

- **Bribing another person (Section 1)**  
This makes it an offence to offer, promise or give an advantage to another person with the intent to induce that person to perform, or to reward that person for performing, a function improperly.

Under the Act “[Strict] liability applies to an organisation which fails to prevent bribery and corruption by those performing services on its behalf”.

vent bribery. Such procedures are the only defence to the new Corporate Offence. Procedures already put in place to satisfy the U.S. Foreign Corrupt Practices Act (“FCPA”), for example, will not necessarily satisfy this requirement.

- **Specific offences applicable to senior management of relevant organisations.**
- **A zero-tolerance approach to so-called “facilitation” payments and corporate hospitality.** This contrasts with the exemption allowed by the FCPA. Payments made to speed up an administrative process or to encourage business will be caught and will be subject only to the discretion of the U.K. authorities as to whether to prosecute or not.

- **Being bribed (Section 2)**  
Any person who requests, agrees to receive or accept an advantage in exchange for, or as a reward for, improper performance commits the offence of being bribed.

#### Discrete offences

- **Bribery of foreign public officials (Section 6)**  
Wider in scope than a similar provision contained in the FCPA, this prohibits the bribery of foreign public officials, such as the holder of a legislative, administrative or judicial position of any kind, or someone who exercises a public function on behalf of a country, territory or public enterprise or is an official or agent of a public international organisation.

- **Failure of commercial organisations to prevent bribery (Section 7) — the “Corporate Offence”**

As discussed in more detail below, when a person commits one of the preceding offences under the new Corporate Offence his organisation is also guilty unless, by way of defence, it can prove that it had “adequate procedures” in place to prevent bribery.

Violations are punishable by up to 10 years in prison and unlimited fines.

### The Corporate Offence

The Corporate Offence of failing to prevent bribery has attracted considerable adverse comment. When it was debated in Parliament as Clause 7 of the Bribery Bill, Lord Goshart said:

*“Clause 7 is a very important clause. Perhaps the most important in the Bill. This is because it is extremely difficult under the present law to prosecute a company for a failure to prevent bribery carried out on its behalf. Clause 7 will require all corporations conducting business to treat bribery as a serious issue and compel them to set up proper systems to prevent bribery on their behalf.”* (Our emphasis).

The offence can only be committed by a “relevant commercial organisation” — an umbrella term encompassing companies and partnerships wherever formed or incorporated, which carry on business or part of a business, trade or profession in any part of the U.K.

The offence is committed by the organisation when a person — an employee, agent or third party or other organisation — performs services on the organisation’s behalf with the intention of obtaining or retaining business or a business advantage for that organisation.

The wording is broadly drawn so as to criminalise the payment of bribes by intermediaries. As it is a strict liability offence, an organisation may be liable even if it did not know of or sanction the act of bribery.

#### **Extra-territorial application**

Again, the Corporate Offence is broadly drawn, with extra-territorial application, and applies potentially to the following entities:

- companies and partnerships established under the law of any part of the U.K.

- foreign companies, foreign subsidiaries of U.K. companies and foreign companies with no U.K. parent may each be liable as long as they **carry on business or “part of a business” in the U.K.** No explanation has been given as to what constitutes “part of a business”, but it is highly probable that it will apply to the U.K. branch of a U.S. or other foreign company.
- an overseas employee, agent or a **foreign subsidiary** of a U.K. company may also cause its **U.K. parent company** to become liable under the Act where the foreign subsidiary commits an act of bribery whilst performing services for the U.K. parent. In contrast, a foreign subsidiary acting entirely of its own account would not make the U.K. parent liable, as it would not then be performing services for its U.K. parent. The U.K. parent could, nonetheless, be liable for money laundering in the U.K. as bribes or profits derived from business secured through a bribe may constitute the proceeds of crime. Similarly, where the accounts of the subsidiary are consolidated with those of the parent, the parent could be liable for false accounting offences.

#### **The Defence of “Adequate Procedures”**

As noted above, companies are required under the Act to introduce and maintain adequate procedures to prevent corruption.

Leaving aside the apparent contradiction between an offence of bribery already having occurred and the contention that there were “adequate procedures” in place to prevent it, the defence is not entire. In particular, it is not available to an organisation if a “senior officer” of the business, or a person purporting to act as such, was negligent in failing to prevent the bribe.

A “Consultation on Guidance” document dealing with what constitutes “adequate procedures” was published by the U.K. Ministry of Justice on 14 September 2010. It indicates that the final Guidance, when published, is unlikely to be detailed but will focus instead on a generic set of principles to be followed by relevant organisations.

In the interim, the Guidance sets out six broad management principles to help commercial organisations decide what bribery prevention procedures they can put in place. Whilst the six principles are intended to reflect U.K. and international good practice and should be generally applicable, they are also intended to be used as a flexible guide to deciding what procedures are right for each organisation.

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## The Bribery Act 2010

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### **Offences by Senior Officers**

When an offence under the Act is committed with the consent or connivance (“turning a blind eye”) of a senior officer of the organisation (or by a person purporting to be one), the officer is guilty of the same offence. Any member of senior management may commit this offence as long as they have a “close connection” to the U.K., whether by nationality, citizenship or residence, for example.

Prosecutorial discretion also has to be relied upon to avoid prosecution in respect of corporate hospitality and promotional expenditure. This has also caused concern, as the general offences can be committed without the wrongdoer even realising that what he or she was doing was illegal.

If the promotional expenditure involves foreign public officials, it does not require any form of actual impropriety for the offence to be triggered.

The U.K. Government’s final word on the “adequate procedures” which must be put in place in order to establish the

## The introduction of the Act adds a further layer of complexity to the in-house procedures that must be adopted by organisations based in the U.K. and elsewhere.

### **Facilitation payments and corporate hospitality**

In contrast to the FCPA, which creates an exception to the usual rules on bribery by allowing payments to facilitate “routine governmental action”, the Act adopts a zero-tolerance approach and provides no specific defences or exceptions to permit facilitation payments or corporate hospitality.

In the debate on the Bribery Bill, a Government spokesman noted that:

***“...many UK businesses still struggle with petty corruption in some markets but the answer is to face the challenge head on rather than carve out exemptions that draw artificial distinctions, are difficult to enforce and have the potential to be abused. Providing exemptions for facilitation payments, as the US does, is not a universally accepted practice and is not something that we consider acceptable.”***

However, whilst technically illegal it does not follow that every facilitation payment will be prosecuted. It is part of a prosecutor’s duty, when deciding to prosecute, to consider not only whether there is a realistic prospect of a successful conviction, but also whether it is in the public interest to prosecute.

Consequently, businesses and individuals making facilitation payments will have to rely upon prosecutorial discretion not to prosecute. Dissatisfied with the uncertainty created by these discretionary powers, leading companies in the U.K. are currently seeking clarification and greater certainty from the U.K. authorities.

defence to the Corporate Offence is awaited with interest. It is, however, reasonably clear that it will involve more than a compliance tick-box exercise. Only an ingrained and documented anti-bribery and corruption culture is likely to suffice.

In its report on “**Anti-bribery and Corruption in Commercial Insurance Broking**” published in May 2010, the FSA identified a broad range of activities as relevant to establishing systems and controls necessary to combat bribery and corruption:

- governance and management information
- pro-active risk assessment and responses to significant anti-bribery and corruption events
- due diligence on business partners
- payment controls
- staff recruitment and vetting
- training and awareness
- risk arising from remuneration structures
- incident reporting and
- the role of compliance and internal audit.

It therefore seems clear that any anti-bribery programme should encompass each of these elements as a minimum for incorporation into the organisation’s internal procedures manual. The introduction of the Act adds a further layer of complexity to the in-house procedures that must be adopted by organisations based in the U.K. and elsewhere, alongside the procedures already required under anti-money laundering, and

trading sanctions compliance procedures, as well as applicable overseas legislation such as the FCPA.

The full text of the Bribery Act 2010 can be accessed from the U.K. Ministry of Justice's website (<http://www.legislation.gov.uk/ukpga/2010/23/contents>).<sup>©</sup>

## Federal Financial Regulatory Reform: What Congress Has Done in respect of (Re)Insurance (So Far)

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In July 2010 the U.S. Congress enacted the Dodd-Frank Wall Street Reform and Consumer Protection Act (the "Act"). As part of the overall federal financial regulatory reform package contained in the Act, Congress has finally legislated limited reforms in the reinsurance and surplus lines sectors<sup>1</sup>. It has also at least opened the door to greater federal oversight of U.S. insurance markets (although the mid-term election results have now made even that proposition uncertain).

The new Act makes a number of significant adjustments to U.S. insurance regulation:

### Federal Insurance Office Established

The Act creates<sup>2</sup>, for the first time, a Federal Insurance Office ("FIO") in the Treasury Department, with a Director appointed by

<sup>1</sup> Within "Title V" of the Act.

<sup>2</sup> Under "Subtitle A" (also referred to as the Federal Insurance Office Act of 2010) of Title V of the Act.

the Treasury Secretary. The FIO has the authority to gather information, to advise the Treasury Secretary on key issues such as terrorism risk coverage and insurance accounting rules, and to send reports to Congress.

The FIO Director will also serve as a non-voting member of the Financial Stability Oversight Council ("FSOC")<sup>3</sup>. Even more importantly, the FIO can also recommend to the FSOC the designation of an insurer as "systemically significant" and therefore subject to regulation by the Federal Reserve as a bank holding company.

In addition, under very limited circumstances, the FIO can declare a state insurance law or regulation "pre-empted"; but this can be done only after extensive consultation with state insurance regulators, the Federal Office of Trade Representative, and key insurance industry players (in trade associations representing insurers and intermediaries).

In this context, pre-emption denotes the declaration by the FIO that a state law is inoperative because it conflicts with federal law. The federal government does not intervene and directly supervise in such circumstances; instead, the state is still charged with supervision but cannot enforce the relevant state law.

The test for such pre-emption is whether the state law or regulation "(A) results in less favorable treatment of a non-United States insurer domiciled in a foreign jurisdiction that is subject to a covered agreement than a United States insurer domiciled, licensed, or otherwise admitted in that State; and (B) is inconsistent with a covered agreement."

Under the Act, a "covered agreement" is defined as a bilateral or multilateral agreement between the U.S. and one or more other countries that "relates to the recognition of prudential measures with respect to the business of insurance or reinsurance that achieves a level of protection for insurance or reinsurance consumers that is substantially equivalent to the level of protection achieved under State insurance or reinsurance regulation."

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<sup>3</sup> The FSOC is charged under the Act with:

1. enhancing the integrity, efficiency, competitiveness, and stability of U.S. financial markets
2. promoting market discipline and
3. maintaining investor confidence

More specifically, the FSOC must, amongst other tasks, collate (and, where appropriate, share) relevant data in order to assess risks to the financial system, monitor the financial services marketplace and make general regulatory recommendations to affiliated agencies.

## Federal Financial Regulatory Reform

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In short, a U.S. state can be obliged not to discriminate against (re)insurers from outside the U.S. if the law of the country of the foreign (re)insurer provides equivalent protection to the law of the U.S. state.

Nonetheless, it is important to keep in mind that, except for this limited pre-emption authority, the FIO has no supervisory authority over insurers generally; and whilst it does have subpoena powers, these must be exercised in coordination with state insurance regulators. Further, the FIO has no authority over (i) **health insurance** (although the determination as to whether an activity constitutes “health insurance” will be made by federal, not state, officials), (ii) **long-term care insurance** that is not otherwise part of a life insurance policy or annuity contract, and (iii) **crop insurance**.

Most significantly for **major** commercial insureds<sup>5</sup>, as a result of the Act, a surplus lines broker need not follow state rules on first obtaining declinations from admitted insurers, if (a) the broker discloses to the insured that its insurance cover might be obtained from admitted insurers with greater protection and regulatory oversight and (b) the insured requests in writing that the broker instead proceed to obtain insurance from a non-admitted insurer.

### Reinsurance Reforms

Again, effective 12 months after enactment, if a ceding insurer’s state of domicile follows NAIC standards, no other state may deny financial statement credit for its reinsurance, regulate the reinsurer’s solvency or regulate the terms of the reinsurance agreement.

The most immediate effect of these provisions will be to end the extra-territorial reach of regulators in states like New York, which historically have imposed their own rules for

...under very limited circumstances, the FIO can declare a state insurance law or regulation “pre-empted”.

### Surplus Lines Reforms

Effective 12 months after enactment of the Act<sup>4</sup>, only the “home state” of an insured may regulate the placement of non-admitted insurance or collect premium tax on property-casualty insurance sold in the “surplus lines” (non-admitted) market in the U.S. This Federal pre-emption does not apply, however, to risk retention groups (e.g., captives) or to workers compensation insurance.

The “home state” means the U.S. state where the insured has its principal place of business or, if the insured is an individual, his or her principal residence.

obtaining credit for reinsurance on ceding companies licensed, but not domiciled there. No longer will a reinsurer headquartered in an E.U. country, but not licensed in the U.S., have to follow the rules of multiple states on each reinsurance transaction. The only rules that it must follow, in terms of providing security for its liabilities, are those of the ceding insurer’s domicile.

### Conclusion

European and Asian (re)insurers, particularly Lloyd’s syndicates and LIRMA companies, will welcome the lifting of multiple, cumbersome state-by-state requirements in the U.S. surplus lines

<sup>4</sup> Except for the interstate “compact” in relation to insurance premium tax, which can be implemented sooner.

<sup>5</sup> For example, those which (i) employ a professional risk manager, (ii) have at least \$100,000 in annual property/casualty premiums, and (iii) have a minimum net worth of \$20 million *or* annual revenues of at least \$50 million *or* at least 500 employees or, if in a group of affiliates, 1,000 employees.

and reinsurance markets.

What remains to be seen is the degree to which the Obama Administration will be more willing than its predecessors to challenge the autonomy of state insurance regulators by adopting in practice the new FIO pre-emption authority conferred by the Act. To date, state insurance officials have been able, throughout the GATT and WTO rounds, to continue regulating non-U.S. insurers and reinsurers without regard to the removal of trade barriers which other industries have enjoyed.

Although there is no immediate sign that the Federal government's traditional deference to these state regulators will lessen, the fact that the U.S. Congress has given the FIO the power to pre-empt, however limited, at least lays the groundwork for future, more significant changes in U.S. insurance regulation. ☺

## Disclose with care! Reinsurance contracts and confidentiality agreements under English law

by Julia Ford, +44 (0) 20-8067, jford@chadbourne.com

In recent years, requests by reinsurers for documents from their reinsureds have often led to drawn-out negotiations as to the basis on which such documents would be released.

In particular, reinsurers have increasingly been required to execute confidentiality agreements as a condition of the release of documents. Such agreements are sometimes referred to as “non-disclosure agreements” (NDAs).

From the perspective of reinsurers, this process may well seem frustrating. From the reinsured's perspective, however, a confidentiality agreement may be a legal necessity as opposed to merely a commercial strategy.

This article examines why, and in what circumstances, NDAs may be required under English law and identifies whether there might be a quicker and more cost-effective approach to the preservation of confidentiality in the context of reinsurance claims.

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### New Addition— Heidi Lawson, Corporate Governance & Risk Management

Heidi Lawson joined Chadbourne & Parke as a partner in September 2010. With regulations becoming more stringent and risk management being brought to the forefront by companies all over the world, Heidi's arrival could not have been better timed. Heidi is qualified in both New York and England and specialises in advising directors and boards on corporate governance and risk management. Heidi has over 20 years experience in the insurance and risk management field which includes spending six months on secondment at the FSA. There are many reasons why you should be speaking with Heidi but, if you and your company are doing any of the following, you should definitely pick up the phone and speak to Heidi today.

- Thinking of expanding into a new jurisdiction
- Considering an internal investigation or regulatory issue
- The board is asking for assessments of the risk management procedures you have in place and how they are protecting you, the board and the company

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## Disclose with care

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### Is there an obligation to provide documents?

Reinsurers require documents from their reinsureds at two key stages in their relationship: first, to enable the underwriter to rate the risk that is to be reinsured, and second to enable the reinsurer to assess any claims subsequently arising under the reinsurance contract.

A reinsurance contract is a contract of utmost good faith, and, in general, a reinsured is obliged to disclose all information material to the relevant risk, prior to the reinsurer becoming bound to that risk.

The common law obligation to provide information to the reinsurer in the **claims** context is generally more limited. In the leading case on this specific issue, *Charman v GRE*<sup>1</sup>, Webster J suggested that, in the absence of an express provision, a narrow implied term entitling a reinsurer to limited, key information **may** nonetheless be construed into a reinsurance contract. He added that evidence of market custom and practice would normally be required to determine the existence and extent of any rights flowing from such an implied term, but even without such evidence:

*“...I will assume, and am to be taken as having decided if necessary, that in the absence of a claims cooperation clause or any clause to the same sort of effect (which is not present in this case) a reinsurer has a right to require the reassured to provide him with information and documents showing, but not necessarily in detail, the claim that was made, how the claim was dealt with (for instance whether by the appointment of loss adjusters, or in-house or by both means), and (if by the appointment of loss adjusters) who they were, sight of all their reports, and the answers to any relevant questions the answers to which might reasonably enable the reinsurer to contend that the loss adjusters had not adjusted or that the reassured had not settled the claim in a business-like way, but not extending to answers to questions necessary to enable the reinsurer to satisfy himself that the claim has been adjusted and settled in a business-like way; for if he was to be entitled to that information he would, in effect, be entitled to require his reassured to prove both liability and the precise reasons why the claim had been adjusted and settled in the way in which it had been (emphasis added)”.*

Similarly, in *Phoenix v Halvanon*<sup>2</sup> Hobhouse J found that, based on the normal test of “business efficacy”, there must, as a matter of principle, be an implied duty on a cedant to “obtain, file or otherwise keep in a proper manner all accounting, claims and other documents and records and make them reasonably available to the reinsurer”. Nonetheless, questions such as the proper scope of “other documents and records” and of the duty to make the various categories of documents and records “reasonably available” are to be determined on a case-by-case basis.

The existence of even this limited implied duty was questioned, however, in *SAIL v Farex*<sup>3</sup> by Lord Justice Hoffmann (as he then was). He considered that rights of inspection were a matter only for **express** contractual stipulation; reinsurers were free to protect themselves by negotiating broader rights of access to information if they considered this to be necessary.

The guidance from the Courts is therefore not altogether clear. The salutary message, however, is that in the absence of a separate agreement (such as an NDA) it is the express wording of the reinsurance contract that will determine what, if any, documents are available to a reinsurer. The combination of “Inspection of Records” and “Claims Control” / “Claims Co-operation” clauses should delineate the exact parameters of what information and documentation the reinsured is obliged to provide in the claims context.

### How do confidentiality obligations impact on disclosure requirements?

There is then the separate question of whether disclosure of documents by a reinsured triggers a duty of confidentiality on the part of the reinsurer.

As a matter of English law, information may be protected as confidential where a party has a “reasonable expectation” of confidentiality or privacy, and another party has agreed to keep the information confidential or at least has notice of its confidentiality. However, as one key commentator, Paul Stanley, has recently emphasised<sup>4</sup>:

*“Where there is an actual contract, the courts’ usual preference seems to be to treat the obligations under the contract as determinative. It is not thought necessary or desirable to rely on some equitable supplement to the contract, but rather the obligations of confidentiality are treated as (and*

<sup>1</sup> [1992] 2 LLR 607, at 614.

<sup>2</sup> [1985] 2 Lloyd’s Rep 599, at 601.

<sup>3</sup> [1995] LRLR 116 (CA), at 152.

<sup>4</sup> *The Law of Confidentiality — A Restatement (2008)*.

*by reference to) the express or implied terms of the contract. The contract governs, and contractual analysis dominates (emphasis added)”.*

It is therefore in the interests of both parties to establish as far as possible beforehand the scope of any confidentiality

- A reinsured may also hold documents disclosed to it in the context of **court proceedings**. The procedural rules of the jurisdiction in which the proceedings are taking place, or specific actions of the relevant court — e.g., in handing down a “protective” order restricting the subsequent disclosure or use of documents obtained during the

## Questions such as the proper scope of “other documents and records” and of the duty to make the various categories of documents and records “reasonably available” are to be determined on a case-by-case basis.

obligations relating to documents that a reinsured is proposing to share with its reinsurer.

There are several legal as well as practical reasons why a reinsured might wish *in advance* to maintain confidentiality in respect of such documents.

### **Obligations to third parties?**

A reinsured may be obliged to produce documents that are subject to legal restrictions that curtail their voluntary disclosure, i.e., the confidentiality that the reinsured is seeking to preserve may not necessarily be within the reinsured’s own control. Amongst the key restrictions on the use of documents that are in a reinsured’s possession, but not necessarily in its control, are those created by: data protection obligations, the assertion of legal professional privilege and orders made by courts and other tribunals.

- Data protection obligations will vary from jurisdiction to jurisdiction, but may arise, for instance, in relation to information held regarding individual insureds.
- A reinsured might hold documents that attract **privilege** in relation to its own rights, e.g., legal advice obtained by it in relation to an inwards claim. Equally, the privilege might belong to a third party, e.g., particularly in the context of professional indemnity insurance. The recent case of *Quinn Direct Insurance Ltd v The Law Society of England & Wales*<sup>5</sup> stressed that an insured solicitor was not entitled, or bound, to disclose to his insurer privileged documents or information held on behalf of his clients, without the clients’ consent.

discovery process — can affect the ability of the reinsured to pass on to its reinsurer documents formally disclosed in the proceedings in that jurisdiction.

The reinsured must be clear as to the scope of the obligations that it owes to third parties. Equally, depending upon the scope of such obligations it is in the interest of the reinsurer to seek to ensure as early as possible that any necessary consent from those third parties is obtained by the reinsured as early as possible, to prevent unnecessary delay.

One practical approach might be for the reinsurer to require the reinsured, at the time they are entering into the contract of reinsurance, to seek consents from readily identifiable third parties, or details of other confidentiality arrangements. This would, of course, involve a detailed discussion regarding what documents were required and from whom they might best be obtained. It is unlikely to be welcome or practical.

### **Commercial sensitivity**

There may also be documents regarding which the reinsured *does* have unfettered control, but which it may legitimately wish to protect following production to the reinsurer, for a number of reasons.

The reinsured might, for instance, wish to protect commercially-sensitive information about its own business that could otherwise be gleaned from placing information. Similarly, in the claims context, commercial information about underlying claims might be of interest to the reinsurer, to any retrocessionaires, to any relevant auditors and regulatory authorities, or, perhaps more significantly, to interested journalists or third parties involved in disputes with the reinsured or its insured.

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<sup>5</sup> [2010] EWCA Civ 805.

## Disclose with care

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The reinsured may of course adopt distinct approaches to each potential recipient. It may have no objection, in principle, if a document is to be shared by the reinsurer with, say, an auditor or retrocessionaire, but it might have a clear objection to any onward dissemination of sensitive commercial information to the world at large.

Again, the precise scope of the reinsurer's ongoing obligations needs to be carefully circumscribed in the NDA, but the reinsured should identify as early as possible the information that it considers to be confidential.

### Conflicting duties?

What if, for instance, a subpoena is served by a third party on a reinsurer, requiring the production of documents that are otherwise subject to confidentiality provisions in an NDA? How can the reinsurer reconcile the duty to respond appropriately to the subpoena with its duty of confidentiality under the NDA?

The duty of confidentiality under English law is *qualified*, so that it must in principle give way to any statutory rule compelling disclosure.<sup>6</sup> Therefore, it would not be possible for the reinsurer to invoke its contractual obligations under NDAs to prevent the disclosure of a document in its possession that it is otherwise required to disclose pursuant to a subpoena (or under Part 31 of the English Civil Procedure Rules, which governs the disclosure of documents in proceedings to which the reinsurer may be a party).

This "qualification" only applies to **English** statutory rules, however. As a consequence, a party subject to disclosure restrictions under an NDA might be obliged to disclose a document in response to the terms of an English Court order but not necessarily that of a U.S. Court.

It is therefore particularly important for both parties to consider in advance to what extent any NDA might permit a party to produce documents further to a subpoena and/or other statutory obligations.

### Conclusions

It is clear from the above that a "one size fits all" approach may not meet all of the challenges that a reinsured's concern to preserve confidentiality poses.

It should nonetheless be possible, either at the pre-contractual

stage (for underwriting information) or contractual stage (for claims information), for a reinsured and reinsurer to agree on a wording that clearly identifies the parameters for sharing and disseminating confidential material. As far as possible, that process should include agreement on what information might belong to third parties and how that might be addressed in advance, as well as agreement on how extra-contractual obligations should be dealt with.

Reinsureds and reinsurers may, in the future, save significant time and costs if confidentiality issues are given due consideration well before problems emerge.📧

## Insurers and intermediaries: How will 2010's VAT changes affect your business?

*by Paul White, +44 (0) 20-7337-8039, pwhite@chadbourn.com*

**C**hanges to the U.K.'s Value Added Tax ("VAT") rules in 2010 have already had a significant impact on the insurance industry, and there may be more to come. This article gives an overview of the main points and suggests methods of mitigation.

As from 4 January 2011, the U.K.'s standard rate of VAT will increase from 17.5% to 20%. Although this is of little consequence for the underwriting of insurance and reinsurance contracts ("supplies of insurance and reinsurance"), which will continue to be exempt, it will significantly increase the irrecoverable input VAT suffered by U.K.-based insurance businesses.

### The "reverse charge" trap — back-office outsourcing

Perhaps that rate increase is a fitting way to end a year which began badly with fundamental changes to the U.K. "place of supply" rules. Those changes brought certain outsourced back-office services within the "reverse charge" regime for the first time.

The reverse charge is a self-reporting, self-accounting VAT procedure for U.K. recipients of supplies from abroad. When

<sup>6</sup> See *Tournier v National Provincial and Union Bank of England* [1924] 1 KB 461 (CA), at 473; *Parry-Jones v Law Society* [1969] 1 Ch. 1 (CA), at 9 (per Diplock LJ).

you buy services from suppliers in other countries, you may have to account for the VAT yourself and effectively act for VAT purposes as both the supplier and the customer. You charge yourself the VAT and, assuming that the service relates to VAT-taxable, non-exempt supplies that you make, you also claim it back, in which case there should be no net cost.

The reverse charge does not apply where the received services would have been VAT exempt had the supplier been in the U.K.

tion, broadly in line with its existing policy, a number of other member states have pushed for a narrower definition which would exclude many back-office functions from the exemption.

Although the U.K. Treasury is continuing to seek comments from industry on the proposals, reports are beginning to surface that the battle may already have been lost. If that proves to be correct, insurers will need once again to review their outsourcing policies so as to maximise any remaining opportunities for exempt treatment.

## The U.K. government may succumb to pressure from other EU member states to apply a narrower view of those insurance-related services which qualify for exemption.

The U.K.'s VAT rules in relation to insurance and intermediary/broking services are over 30 years old, and in the intervening period the outsourcing of back-office functions has grown significantly. An influential factor in that growth has been the tax advantages, including VAT savings, of "off-shoring". In some cases, the provision of services such as claims handling, accounting support and IT maintenance, which otherwise might be expected to be standard-rated for VAT purposes, have been accepted by HM Revenue and Customs ("HMRC") to be within the insurance VAT exemption when supplied to insurance businesses. The extension in early 2010, however, of the reverse charge regime to the supply of certain back-office functions signalled a change and, as a result, U.K. insurers have begun to suffer irrecoverable VAT on outsourced services, even where the service provider is established outside the European Union ("EU") member states.

The potentially negative consequences of this have to some extent been mitigated by HMRC's arguably generous view to date of which offshore back-office services would qualify for exemption from VAT if they had been supplied in the U.K. However, in recent months a number of press reports have indicated that the U.K. government may succumb to pressure from other EU member states to apply a narrower view of those insurance-related services which qualify for exemption.

The EU is in the process of reviewing its policy on VAT exemptions for insurance and financial services, and a key consequence is likely to be a revised definition of exempt services for the insurance industry. Whilst the U.K. has proposed a wide defini-

### Rise in standard rate of VAT

Whatever the outcome of the European debate, the irrecoverable VAT suffered by U.K. insurance businesses will inevitably increase in 2011 as a result of the rise in the standard rate of VAT to 20%, with effect from 4 January 2011. Insurance businesses, in common with other partially-exempt businesses, should be considering urgently their year-end billing and payment arrangements for supplies received either side of 4 January 2011 or which, in the case of some services, actually straddle that date.

It is likely that the default position for most suppliers will be to charge VAT at 20% on all invoices issued after 4 January 2011, even when the supply actually took place before that date. Although most businesses will recover their input VAT in full, insurance and other partially-exempt businesses will unnecessarily increase the irrecoverable VAT which they suffer by unthinkingly paying VAT at 20% on all post-4 January invoices. Partially-exempt businesses should instead consider asking their suppliers to apportion such invoices so that the element of consideration referable to pre-4 January supplies is charged at 17.5%. Clearly, this may be seen as an inconvenience for suppliers, so an early approach on this basis is likely to get a more sympathetic response.

Better still, there is some opportunity to mitigate the initial cost of the increase by, in effect, asking suppliers to invoice early. In some cases, the VAT "time of supply" is ascertained by reference to the date of an invoice rather than the date on which a supply is actually made. So, an early invoice can advance the "tax point" for post-4

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January supplies and, if issued before the rate increase, reduce the rate charged. If the “tax point” is before the date of the change, the current rate of 17.5% applies, even though the services may actually be carried out after 4 January.

This may sound too good to be true, and the potential for advancing the “tax point” to benefit from the 17.5% rate is not open-ended. In order to stop abuse, there are “anti-forestalling” measures which, for example, would prevent this technique being used in relation to back-office services supplied by a connected party. However, in relation to third-party transactions on genuine commercial terms, insurance companies, along with other partially-exempt businesses, do have the opportunity to mitigate the initial cost of the rate increase.

### “Click through” services

Finally, in an otherwise gloomy year, a little good news. HMRC has issued new guidance following its defeat in the Court of Appeal case, *HMRC v Insurancewide.Com Services Ltd*. The Court’s decision is not to be appealed, and HMRC now accepts that internet introduction services which direct potential clients to insurers, so-called “click through” services, may be exempt for VAT purposes provided (in particular) the service provider is more than a mere conduit.

In order to meet this test, the service provider will need to satisfy four conditions:

- the services are provided by someone engaged in the business of putting insurers in touch with potential clients;
- the business provides the means by which potential clients are introduced to insurers;
- that introduction is made when the potential client is looking for insurance; and
- the introducer plays a proactive part in putting in place the arrangements under which the introduction is effected.

This guidance is a useful explanation of how the VAT exemption will be applied to web-based intermediary services, and HMRC has even confirmed that businesses can reclaim qualifying VAT overpaid under the old rules. ☺

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