Insurance & Reinsurance - Sweden

The Uncontroversial Reform: Speculations on the Insurance Business Law Revamp

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October 21 2008

Background

"New Insurance Business Act" reported that a new Insurance Business Act is in the making. The new act will likely be based to a large extent on a 2006 proposal of the Insurance Company Committee.(1)

The proposal met with severe criticism from the insurance industry and important government bodies, such as the Swedish Financial Supervisory Authority (SFSA). The objections focused almost entirely on two issues, of which the second proved most controversial: (i) the proposed methods for strengthening policyholder influence in mutual life insurance companies, such as Folksam Life; and (ii) the proposed procedures for demutualization of limited liability life insurance companies operated on a mutual basis (generally referred to as 'hybrid companies'),(2) such as Skandia Life.

The Ministry of Finance soon announced that the modernization of the outdated existing Insurance Business Act (1982/713) will proceed in two phases. First, the ministry plans to launch a proposal relating to uncontroversial insurance business matters. Thereafter, the ministry intends to deal with the more controversial issues. Whether this will mean that both of the two issues outlined above will be postponed, or only the second, remains to be seen.

Although hypothetically uncontroversial, the committee's proposals that do not relate to the above issues would still result in substantial changes and a significant modernization of the existing legislation. Any draft put forward by the Ministry of Finance based on the committee's proposal will therefore be of the utmost importance to the insurance industry.

The possible publication date of the first Ministry of Finance proposal has been changed many times. It is now anticipated that it will be presented before the end of 2008. The delay has been attributed to the aim of providing for implementation of the EU Cross-border Merger Directive (2005/56/EC).

This update speculates on the possible contents of the forthcoming proposal from the Ministry of Finance, excluding the two issues outlined above.

General Principles

Not least due to the EU Insurance Directives and the forthcoming Solvency II regulations, it is clear that a number of special regulations will continue to apply to insurance businesses in Sweden. The regulations will undoubtedly also continue to focus on policyholder and third-party protection issues. Further, the regulations must avoid creating any unjustified distortion of competition between Swedish and other European Economic Area insurance companies.

General Structure

Most major Swedish banks own life insurance companies. Some banks have also entered the non-life market. Further, most major Swedish life insurance companies have their own banks. Consistency between banking and insurance regulations will therefore be a priority from a legislative and supervisory point of view.

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Further, any new Insurance Business Act will probably follow the structure of the well-received 1999 banking and finance reform. This reform made the general Companies Act (2005/551) - by virtue of reference in the Banking and Finance Act (2004/298) - applicable to banks limited by shares.(3) Prior to 1999, Swedish banks were special purpose vehicles, established and regulated solely by the banking legislation.

The Insurance Business Act

The underlying basis for the proposal was laid out in directives(4) of the Ministry of Finance. In accordance with those directives, the proposal has been based on a model whereby the existing Insurance Business Act (which regulates mutual and limited liability insurance companies) and the Friendly Societies Act (1972/262), which regulates friendly societies, will be rescinded and replaced with a combined new Insurance Business Act. It is unlikely that the Ministry of Finance will retreat from this position.

Limited liability insurance companies
In a new combined Insurance Business Act it is clear that (by reference) the Companies Act will be applicable to limited liability insurance companies (whether hybrid or profit distributing).

Friendly societies
In a new combined Insurance Business Act it is likely that (by reference) the general Cooperative Societies Act (1987/667) will be applicable to friendly societies.

Mutual insurance companies
Whether the Companies Act or the Cooperative Societies Act will be applicable to mutual insurance companies is a controversial issue.

Technically, it appears that a mutual insurance company has a legal structure that in most respects is based on principles for cooperative associations (ie, the customers are the owners). The committee has thus suggested making the general Cooperative Societies Act applicable to mutual insurance companies. However, few Swedish mutual insurance companies are managed in accordance with those principles. Many features of leading Swedish mutual insurance companies are instead borrowed from general company law. One reason for this is the fact that voting power often lies in the hands of organizations such as trade unions (claiming to represent the interests of the policyholders), not the individual policyholders.

Hence, the choice of applicable regulation is closely connected to the controversial issue of policyholder influence. The position taken by the Swedish Federation of Insurance Companies(5) is that the Cooperative Societies Act is outdated and otherwise unsuitable.

It will be interesting to see whether the Ministry of Finance has the courage to follow the proposal and base the regulation of mutual companies on what may appear logical from a technical perspective (ie, by reference to the Cooperative Societies Act), or whether it will yield to demand from a number of politically influential organizations (ie, by reference to the Companies Act).

In terms of consistency, the Banking and Finance Act regulates only bank companies limited by shares. Mutual banks are regulated by separate legislation.(6) In a worst-case scenario, Sweden might thus end up with more than one new Insurance Business Act. It is also possible that the Ministry of Finance could decide to avoid all controversy relating to this issue by retaining the existing structure (ie, including all necessary provisions for regulating mutual insurance companies in the Insurance Business Act).

Key Issues

As mentioned above, a number of reform issues are uncontroversial by comparison with the two main points of contention outlined above. Nevertheless, there follows a summary of some issues that might still have a significant impact at a business level. Unless otherwise indicated below, the summary focuses only on issues of relevance to limited liability insurance companies.

Authorization and the legal entity
An important consequence of the proposed future applicability of the Companies Act in relation to limited liability insurance companies is the fact that such companies will cease to be special (insurance) purpose vehicles. Insurance companies limited by shares will no longer be incorporated under a special incorporation authorization (referred to as a 'concession') . They will become ordinary companies with a permit to conduct insurance business. This means that an existing ordinary company may become an insurance company.(7)

A company that has already been granted a permit to become an insurance company will also be able to change its line of business. However, to ensure consistency with the Banking and Finance Act, the committee has proposed that an insurance company will be able to become another kind of regulated entity only (ie, another kind of financial institution, such as a bank).(8) Today, for tax reasons (eg, through the creation of untaxed reserves), a significant amount of capital is locked in as assets of insurance companies. The opportunity for diversification of a less successful insurance operation should therefore be of great interest to several insurance companies (as well as their consultants), even if this is limited to other regulated financial activities.

The insurance industry appears to have made no objections in relation to the above features of the proposal. In light of the proposed consistency with the Banking and Finance Act, it is likely that the

Ministry of Finance will come to the same conclusion as the committee.

Under the proposal, mutual insurance companies and friendly societies would remain special purpose vehicles. It would be possible to obtain a permit to conduct insurance activities in this form only if the mutual insurance company or friendly society were incorporated following receipt of the permit to conduct insurance business.(9) This line of policy undermines the committee's recommendation that the regulation of mutual insurance companies should be based on the Cooperative Societies Act. Arguably, the prevailing impression is that the committee agrees with the Insurance Federation's opinion that the Cooperative Societies Act is either outdated or otherwise unsuitable for mutual insurance companies. It will be interesting to see how the Ministry of Finance deals with this matter. Ultimately, it may well conclude that the simplest solution is to stick with the existing legislative structure - at least for mutual insurance companies.

Portfolio transfers

The existing Insurance Business Act states only that the SFSA should consider the rights of policyholders when examining whether a permit for a contemplated portfolio transfer should be granted.(10) However, the committee has indicated that the SFSA also considers the interests of insureds and beneficiaries in its decisions relating to proposed portfolio transfers.(11) The committee's suggestion to include such considerations in the wording of the new provisions(12) has met with no objections from the insurance industry.

Further, the committee has suggested retaining the existing stipulation that an insurance company must enter into liquidation if it transfers its entire insurance portfolio.(13) As noted, the committee has proposed that it should be possible for an insurance company to revoke its insurance permit and avoid liquidation by applying for another kind of authorization (eg, as a bank). However, the committee has not explained how an insurance company with a substantial portfolio of insurance policies could exchange its insurance permit (eg, for a bank permit) without first having transferred its insurance portfolio. It is hoped that the Ministry of Finance will provide clarification in this respect.

Demergers

According to the proposal,(14) insurance companies should be able to enter into a public demerger procedure whereby a court of law, after examination by the SFSA, can grant the insurance company the right either to: (i) transfer all of its assets and liabilities to two or more other legal entities (whether existing or newly established), following which the insurance company would be automatically dissolved (without any liquidation procedure); or (ii) transfer a part of its assets to one or more other legal entities (whether existing or newly established). However, the regulated part of an insurance company's activity must be transferred to another insurance company (or insurance companies).(15)

As indicated above, Swedish insurance companies have been (and will continue to be) able to transfer their portfolios of insurance policies to other insurance companies. However, a portfolio transfer procedure relates only to the insurance company's insurance undertakings. Transfer of other debts and liabilities of the transferee has been achievable only through a merger or subject to the individual consent of each relevant creditor. Demergers will thus simplify the transfer of complex businesses in cases where a merger or a complicated renegotiation of outstanding liabilities is not desirable.

The fact that insurance companies will be able to make use of the proposed demerger procedure for transfer of non-regulated parts of their activities to companies that are not insurance companies is another innovation. Further, compared to a 100% portfolio transfer, a demerger whereby all assets and liabilities are transferred will result in the immediate dissolution of the insurance company instead of the sometimes complicated liquidation procedure that now follows from a total portfolio transfer.

It is difficult to identify any reason why the Ministry of Finance would not wish to allow insurance companies to utilize demerger procedures.

Mergers

According to the existing Insurance Business Act,(16) a merger is a procedure whereby either: (i) one insurance company acquires all of the assets in one or more other companies (whether insurance companies or not); or (ii) one company, together with one or more other companies (whether insurance companies or not), transfers all of its assets to a newly established insurance company.

The SFSA's position is that a merger which includes the transfer of insurance policies can be achieved only through a combination of a portfolio transfer procedure (relating to the rights of the policyholders) and a merger procedure (relating to the rights of all other creditors). According to the committee, however, this is a misunderstanding of the legislative intent. Through the new Insurance Business Act, it will be made clear that a merger - like a demerger - is an alternative to a portfolio transfer.(17) This means that a merger procedure will include all liabilities of the insurance company (whether to policyholders or others). This clarification should simplify any future mergers.

As indicated above, the finalization of the Ministry of Finance's first proposal for a new Insurance Business Act has been held up due to the aim of including provisions for implementation of the EU Cross-border Merger Directive. One can only speculate on how this liberalization of Swedish law will change the structure of established and future cross-border insurance company acquisitions, such as the Old Mutual/Skandia transaction and the recent Storebrand/SPP transaction.

Share capital

The SFSA's position is that when examining an application for incorporation of a new insurance company, it is entitled, "for reasons of stability", to require that the insurance company have a certain

share capital in excess of the minimum requirements.(18) However, there is no clear support in the existing Insurance Business Act for this regulatory practice. The committee has suggested that, in addition to the minimum requirements in general company law, the new Insurance Business Act should require insurance companies to have a share capital level "adapted to the extent and nature of the planned activities".

In the opinion of the Insurance Federation, the proposed share capital provision at the SFA's practice in this regard lack legal merit. The only relevant capital requirement under the EU directives and the forthcoming Solvency II regulations relates to the capital base. Whether the capital base consists of share capital or other tier-one capital should be of no concern to the Swedish regulator.

The Banking and Finance Act contains the same share capital requirement for banks as that proposed by the committee for insurance companies.(19) For reasons of consistency, it is thus likely that the Ministry of Finance will ignore the comments made by the Insurance Federation.

Conflicts of interest

To ensure consistency with the Banking and Finance Act, the committee has proposed that Swedish insurance companies should no longer be able to enter into agreements with any person or company closely connected to the insurance company (eg, employees, directors, certain shareholders), or family members or companies closely connected to such persons or companies, unless any such agreement is:

- approved by the board of directors;
- registered in a specific register; and
- entered into on normal conditions or otherwise with a business purpose.(20)

It is likely that the Ministry of Finance will be in favour of this proposal.

Loan prohibition

Swedish limited liability companies are subject to a loan prohibition. This means that they cannot lend money to or grant security: (i) in favour of shareholders or directors of the board or the managing director, or persons or companies closely related to such persons or companies; or (ii) with the intent that the borrower shall be able to acquire shares in the company.(21) However, in light of the nature of their operations, banks are (with certain important modifications) exempt from the loan prohibition,(22) and insurance companies are exempt from the first part of the loan prohibition as regards lending money to or granting security in favour of shareholders.(23)

In connection with the above solution concerning agreements with closely connected persons or companies, the committee pondered over the delicate issue of whether the exemptions from the loan prohibition in the Banking and Finance Act could be extended to insurance companies. It concluded that the exemption relating to the prohibition against lending money to or granting security in favour of shareholders could be expanded to include directors of the board and the managing director (and closely related persons or companies). However, the committee remained reluctant to allow insurance companies to be exempted from the second part of the provision.(24)

The main reason for upholding the loan prohibition when the new Companies Act was introduced by the socialist government in 2005 was the fact that a loan prohibition makes it more difficult for owners and management of smaller companies to make use of loans in order to avoid taxation of dividends and salary. However, these considerations are less relevant to insurance companies. It is thus possible that the current liberal government may be more likely to grant insurance companies the same exemptions from the loan prohibition as banks.

Secrecy

According to the Banking and Finance Act, a bank is not entitled to reveal details of its business relations with a customer unless the information is required for a criminal inquiry.(25) The committee did not make similar proposals for insurance companies, on the understanding that the advantages and disadvantages thereof would be considered by another committee.(26) However, the Insurance Federation has pointed out that there is an urgent need for a solution, as most insurance companies already undertake to apply such secrecy, although they are under no legal obligation to do so. The Insurance Federation fears that in the absence of supporting legal provisions, contractually applied secrecy may conflict with a public duty to provide information. The Ministry of Finance will likely have to deal with this matter in its forthcoming proposal.

Contribution principle

If nothing else has been agreed between an insurance company and its policyholders, any profit to be distributed to policyholders shall be divided between them in relation to each policyholder's contribution to the profit (the contribution principle).(27) When the computation is made, each class of insurance shall be considered separately.

The committee has suggested that the contribution principle is unnecessary and should be abolished,(28) as all insurance companies, according to SFSA instructions,(29) are liable to disclose clearly to each policyholder which profit distribution techniques will apply to his or her policy. However, the SFSA has objected to this proposal, pointing out that profit distribution matters are not always clear and that the existence of a principle, although not mandatory, will provide a useful basis for handling unclear profit distribution issues from both a consumer and a supervisory point of view.(30) With a consumer protection objective in mind, it is likely that the Ministry of Finance will have to consider the SFSA's opinion.

Directors' and officers' liability issues

Many of the insurance law reforms in recent years have emanated from various scandals and expressions of mistrust among policyholders against the management of some life insurance companies. It was thus somewhat surprising that the committee proposed limitations of the liability of the managing director and the board of directors for damages caused to shareholders and other third parties,(31) by abolishing those persons' liability for breaches of technical guidelines and investment guidelines.(32)

The committee further proposed the abolishment of the liability of the actuary for damages caused to the company or its shareholders and other third parties.(33) According to the committee, this is because the responsibility of the board of directors and the managing director would become clearer as a result.(34) However, the commentary to the existing Insurance Business Act states(35) that the assessments made by an actuary call for "specialist competence" and further notes that "important decisions of the board of directors and the management director" are based on this. Even the insurance company's auditors are "completely dependent on the actuary". Given that any liability of the board of directors and the managing director is negligence based, it is thus unlikely that a court of law would find a director of the board or a managing director liable for damages due to actuarial mistakes.

It is difficult to see how either of these two proposals, partly based on considerations made by a previous committee some 13 years ago,(36) would enhance customer protection. Further, as regards the proposed absence of liability for actuaries, there is also a risk that the status and position of the actuary in the company will be devalued, to the detriment of policyholders. Consequently, there are several reasons why the Ministry of Finance may hesitate to implement the suggestions made in the proposal.

Outlook

The possible publication date for the forthcoming Ministry of Finance proposal has been changed many times. It is now anticipated that publication will occur before the end of the year. If and when that happens, it will remain to be seen whether the contents will reflect the predictions made in this update.

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Endnotes

(1) SOU 2006/55, Final report of the Swedish Insurance Company Committee.

(2) A life insurance company that, although limited by shares, does not have the right to distribute any profits to its shareholders.

(3) There are other kinds of banks in Sweden regulated by other legislation (eg, savings banks).

(4) FI 2003/10.

(5) www.forsakringsforbundet.com/templates/News____212.aspx?epslanguage=SV

(6) The Savings Bank Law (1987/619) and the Mutual Bank Law (1995/1570).

(7) SOU 2006/55, page 257.

(8) SOU 2006/55, page 298.

(9) SOU 2006/55, page 321.

(10) Insurance Business Act, Chapter 15, Section 3.

(11) SOU 2006/55, page 551.

(12) SOU 2006/55, page 298.

(13) SOU 2006/55, page 298.

(14) SOU 2006/55, page 289.

(15) SOU 2006/55, page 292.

(16) Insurance Business Act, Chapter 15 a, Section 1.

(17) SOU 2006/55, page 293.

(18) SOU 2006/55, page 252.

(19) Banking and Finance Act, Chapter 10, Section 2.

(20) SOU 2006/55, page 286.

(21) Companies Act, Chapter 21, Sections 1 to 6.

(22) Banking and Finance Act, Chapter 10, Section 17.

(23) Insurance Business Act, Chapter 12, Section 12.

(24) SOU 2006/55, page 287.

(25) Banking and Finance Act, Chapter 1, Sections 10 to 12.

(26) SOU 2006/55, page 265.

(27) Insurance Business Act, Chapter 12, Section 6.

(28) SOU 2006/55, page 283.

(29) FFFS 2003/7 and 2006/2.

(30) Fi Dnr 06-6243-001, page 4.

(31) Insurance Business Act, Chapter 16, Section 1.

(32) SOU 2006/55, page 306.

(33) Insurance Business Act, Chapter 16, Section 1.

(34) SOU 2006/55, page 306.

(35) *Kommentar till försäkringsrörelselagen*, *tredje upplagan*, page 230.

(36) *Försäkringsutredningen*, SOU 1995/87.

Comment or question for author