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Changes in supervision procedures of insurance companies and in civil dispute resolutions

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1. THE ACTIVTIES OF INSURANCE AND REINSURANCE LAW HAS ENTERED INTO FORCE

Directive 2009/138/EC of the European Parliament and of the Council on the taking-up and pursuit of the business of Insurance and Reinsurance (Solvency II) was adopted on 25 November 2009. In accordance with Solvency II Directive Member States must implement changes to their insurance and reinsurance supervisory systems. These changes are mainly aimed towards improving the financial stability of the insurance sector.

In order to implement the requirements of the directive in Latvia's legal framework, on 18 June 2015 in the final reading Parliament passed the Law on Insurance and Reinsurance, which entered into force on 1 July 2015. Nevertheless some provisions of the law will only enter into force on 1 January 2016 with the expiry of the Law on Insurance Companies and Supervision Thereof and the Law on Reinsurance as well as the regulations issued on the basis of these laws. The regulations of the new law mainly apply to insurance and reinsurance companies.

1.1. Capital requirements

The new law significantly changes the requirements for setting and evaluating solvency capital and minimum capital for insurance companies. The new procedures will be applied from 1 January 2016, therefore insurance and reinsurance intermediaries must ensure compliance with the new capital requirements by the beginning of next year.

The solvency capital requirement

Previously regulations stipulated that solvency capital was calculated based on the amount of insurance premiums. The new law stipulates that market, credit and operating risks to which the insurer or reinsurer is exposed are also taken into account when calculating solvency capital requirement. This means that the nature of new regulations relates to a broader assessment of factors affecting solvency.

Insurance and reinsurance undertakings are also obliged to calculate solvency capital at least once per annum, and to report the results to the Financial and Capital Market Commission ("**the Commission**").

The company's internal model

The law permits insurance and reinsurance companies to fully or partially use the company's own internal solvency evaluation model for calculating solvency capital requirements. The internal model is a risk evaluation mechanism developed by the company to calculate solvency capital requirements and which takes into account the most significant risks to the insurance company and other specific circumstances directly affecting the specific company.

Permission from the Commission must be received before using the internal model for calculating the company's solvency capital requirements. In this case, the insurance or reinsurance company must submit an application to the Commission which includes evidence that the selected internal model complies with laws and regulations. Once the Commission has ascertained that the selected model is compliant and that the company's risk identification, supervisory management and reporting systems are appropriate for the respective company's commercial activities and risk profile, it shall issue the permit requested in the application.

However, even when permission is granted for usinf the internal model for calculating a company's solvency capital requirements, pursuant to the new law the Commission may still require the company to calculate solvency capital requirements in accordance with the standard formula stipulated in the law.

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The minimum capital requirement

The procedures for calculating minimum equity capital are determined in accordance with Regulation 2015/35 supplementing Directive 2009/138/EK of 25 November 2009, and it must not be less than the legally stipulated absolute floor of equity capital value:

- non-life insurance companies – EUR 3.7 million or EUR 2.5 million depending on the types of non-life insurance offered;
- life insurance companies – EUR 3.7 million;
- reinsurance companies – EUR 3.6 million;
- captive reinsurances companies[1] – EUR 1.2 million;
- companies providing both life and non-life insurance – EUR 7.4 million or EUR 6.2 million depending on the types of non-life insurance offered.

Ensuring that equity capital aligns with the absolute floor of capital value is a precondition for receiving an insurance or reinsurance license. Therefore, if equity capital is below the absolute floor value a license will not be granted. In the event that a license is granted but the insurance company's equity capital falls below the stipulated absolute floor value, pursuant to the Law on Insurance and Reinsurance the Commission may annul the license.

The minimum capital requirement is calculated pursuant to Regulation 2015/35, and it must not be less than 25% of the company's solvency capital

[1] A captive reinsurance company is a reinsurance company which is, firstly, owned by: a) a financial commercial entity which is not an insurance or reinsurance commercial entity or b) an insurance or reinsurance group or a non-financial commercial entity therein; and, secondly, whose function is to provide reinsurance only for a) the risks of the commercial entity or entities which own it, or b) only to the commercial entity or entities of the group of which the captive reinsurance company is a member.

requirement. Minimum capital must be calculated at least once per quarter and the results must be submitted to the Commission.

If the minimum capital requirements do not comply with the provisions of the law, the company must submit information to the Commission regarding the reasons for non-compliance. In this event, the company must prepare a plan for restoring equity capital to the minimum capital requirements, which must be done within three months.

The Commission shall annul a company's license if the insurance or reinsurance company does not observe minimum capital requirements and the Commission considers that the plan for restoring equity capital to the minimum capital requirements is inadequate, or if the respective company does not implement the aforementioned plan within three months of the finding of non-compliance with minimum capital requirements. In this case, the law does not directly provide for a repeated opportunity for the company to rectify the infringement and the Commission is obliged to annul the license.

"[..]the Commission shall be empowered to require that an insurance company's meeting of shareholders, council or board remove from their position any member of the board or council, the head of the internal auditing department, the branch manager of a non-Member State insurer, or any other person who when acting in the name of the company could create liabilities under the civil law for the company."

1.2. Transferring insurance contracts

Regarding the transferring of insurance contracts (insurance portfolios), the new law reiterates the transfer procedures in operation until now, with the exception that the new regulations are supplemented with provisions regarding the obligations of the transferee and recipient of the portfolio.

As a result of the transfer of contracts, all obligations arising from these contracts shall be binding on the recipient of the insurance portfolio. Transfers of insurance contracts are not subject to the provisions on joint and several liability between the transferee and the recipient which pursuant to Article 20 of the Commercial Law apply in the event of the transfer of a company, and as a result of which fulfilment of obligations can be demanded from both the recipient and the transferee.

Also, in relation to insurance contracts transferred in the process of splitting-up an insurance company, in contrast to the provision for joint and several liability between the companies involved in the reorganisation stipulated in Article 351 of the Commercial Law, only the receiving insurance or reinsurance company shall hold liability.

It is emphasised in the law that transferring an insurance portfolio does not require the consent of the other parties to the contracts transferred, moreover in the event of transferring a contract the provision of information regarding these contracts to the transferee of the obligations shall not be considered a breach of confidentiality or data protection requirements.

1.3. Timeframe for the Commission to adopt decisions

There are also changes regarding the timeframe in which the Commission must adopt decisions on granting licenses to insurance and reinsurance companies, as well as to non-Member State insurance companies for performing insurance activities. Until the onset of the new procedures the aforementioned decision will have to be adopted within three months, however from 1 January of next year the Commission will adopt decisions on granting licenses within six months.

A six-month timeframe is also provided for decisions on permission to use internal models for calculating and setting solvency capital requirements.

This timeframe is referenced in the law in order to inform recipients of decisions that the timeframe for examining administrative matters in these matters differ from general regulations governing institutional administrative processes.

1.4. Liability and revoking of representatives

Pursuant to the Law on Insurance and Reinsurance as well as other regulations governing insurance and reinsurance activities, full liability for breaches of these laws and regulations is held by the board of the insurance or reinsurance company.

In the event of breaches, from 1 January of next year the Commission shall be empowered to require that an insurance company's meeting of shareholders, supervisory board or management board remove from their position any member of the management board or supervisory board, the head of the internal auditing department, the branch manager of a non-Member State insurer, or any other person who when acting in the name of the company could create liabilities under the civil law for the company. In the event that imposition of the aforementioned obligations on the company is connected with the finding of breaches of laws and regulations, this may create a risk of liability by the person to be dismissed for the company or its creditors, and also such a decision may have a certain prejudicial significance if a dispute arises regarding material losses or the termination of legal relations with the company.

2. AMENDMENTS TO THE CVIL PROCEDURE LAW'S SECTION ON REGULATIONS GOVERNING CIVIL PROCEEDINGS

When resolving disputes through court proceedings, changes to the Civil Procedure Law which could affect both current cases and in filing new suits must be taken into account.

A new principle of civil procedure has been prescribed, namely *"parties, third persons and representatives acting on their clients' behalf shall present truthful information to the court regarding the facts and circumstances of the case"*. The initial draft amendments to the law also imposed the obligation to provide truthful explanations, however after the second reading Parliament's Legal Affairs Office recommended that these words be struck out. Taking into account that pursuant to the Civil Procedure Law explanations by parties and third persons encompass information about facts it can be concluded that the aforementioned principle is also to certain extent applicable to explanations provided by participants in a case.

The regulations of the Civil Procedure Law have been supplemented with a requirement that a court must inform persons participating in a case in writing that the case materials contain information that is deemed to be a commercial secret. In this way the court also informs the persons of their obligation not to disclose commercial secrets and of the consequences stipulated for disclosure. Considering the aforementioned, the Civil Procedure Law *expressis verbis* encompasses the principle of protecting commercial secrets, which can assist participants in a case in protecting sensitive commercial information in the course of legal proceedings and in the event of protecting one's legal interests which have been infringed.

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Significant changes have also been made to regulations governing the transferring of a case accepted for legal proceedings to anther court to facilitate the speedier hearing of the case. It was previously stipulated that a court of the first instance could recommend transferring a current case to a court of the same instance if the hearing of the case has not commenced and the result could be a speedier hearing of the respective case. Case transfer was not applicable in the case of legal proceeding in which jurisdiction is determined in accordance with the plaintiff's choice or exceptional jurisdiction or contractual jurisdiction is applied. Pursuant to the amendments to the Civil Procedure Law, from 26 May of this year a court also has the right to recommend the transfer of a case in the event that the jurisdiction of the court is determined in accordance with the plaintiff's choice or exceptional jurisdiction is applied. Therefore, the transfer of a case is not permissible only in the event of contractual jurisdiction. On the other hand, if jurisdiction is determined in accordance with the plaintiff's choice or exceptional jurisdiction is applied, a court may transfer a case for hearing to anther court only the basis of a written request from the plaintiff.

The Civil Procedure Law has been clarified to stipulate that in the event that a claim is dismissed, is left unheard or the plaintiff withdraws the claim, court costs that have not been paid in advance shall be recoverable from the plaintiff for the benefit of the state. However, if the plaintiff withdraws its claim because the defendant has satisfied the claims voluntarily after the suit was filed, court costs shall be recoverable from the defendant for the benefit of the state. The legislature has thus expanded the listing of cases in which court costs shall be recoverable from the plaintiff and in which cases they shall be recoverable from the defendant for the benefit of the state. If, for example, in the course of legal proceedings the defendant has satisfied the claims voluntarily, stamp duty and costs connected with the case shall be recoverable in state duties from the defendant.

"[..]if a court has applied a legal provision which should not have been applied in the concrete case, and this has resulted in an incorrect judgement, the judgement of the cassation court shall not be overturned on these grounds; instead, issues relating to the application of the respective legal provision shall be explained."

3. DEVELOPMENTS IN HIGH COURT CASE LAW

A significant opinion regarding evaluation of the consequences of applying material legal provisions was expressed in the recently published judgement of the High Court in Case No SKC-89/2015.

The High Court ruled that if a court has applied a legal provision which should not have been applied in the concrete case, and this has resulted in an incorrect judgement, the judgement of the cassation court shall not be overturned on these grounds; instead, issues relating to the application of the respective legal provision shall be explained. This means that if a judgement is appealed and the reach of legal provisions in the ascertained materials is not of such a nature that would affect the outcome of the case, the cassation court is not compelled to overturn the judgement and return the case for trial to a lower court. This complies both with the will of the legislature and with considerations of justice and efficiency in proceedings.

CONCLUSION

It is possible that the main beneficiaries from the new supervisory system for the insurance sector will be the clients of insurers, since the primary aim of the rules on calculating capital requirements is to ensure that insurance companies are able to meet their obligations. Assessing the overall situation in the insurance market, it appears that insurance companies are taking a

firmer stance on insurance pay-outs. This could lead to more litigation under the Civil Procedure Law.

The resolution of disputes in court may be affected by recent amendments to the Civil Procedure Law, which are chiefly aimed at improving the discipline and honesty of parties in cases and improving the efficiency of civil proceedings, which may have an impact on almost all civil cases and may affect prevailing court practices.

The ruling by the High Court that not every material infringement of legal provisions may be grounds for overturning a judgment by a cassation instance court and that the possible impact of such an infringement on the overall result of the case must be considered, is a significant step towards speeding up the hearing of cases.

Law firm VILGERTS

We are a leading regional law firm with offices in Latvia, Estonia, Lithuania and Belarus. Our headquarters is in Riga. We help our international and local clients in their most challenging legal matters as well as everyday legal issues. We take client matters personally and create solutions to achieve goals efficiently.

Our team has over 20 attorneys with outstanding academic backgrounds and extensive business knowledge. Our firm's roots go back to 2008, with the establishment of the first VILGERTS office in Riga, Latvia.

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