Summary

Final report from the Swedish Insurance Company Committee

Slutbetänkande av
Försäkringsföretagsutredningen

Stockholm 2006

STATENS OFFENTLIGA UTREDNINGAR

SOU 2006:55

This report is on sale in Stockholm at Fritzes Bookshop, which sells reports in the series Swedish Government Official Reports (SOU) and in the Ministry Publications Series (Ds).
Fritzes Bookshop also distributes these reports on behalf of the Office for Administrative Affairs at the Government Offices when they are circulated for formal consultation.

Address: Fritzes, Customer Service
SE-106 47 Stockholm
Sweden

Fax: 08 690 91 91 (national)
+46 8 690 91 91 (international)

Tel: 08 690 91 90 (national)
+46 8 690 91 90 (international)

E-mail: order.fritzes.@nj.se
Internet: www.fritzes.se

Printed by Edita
Stockholm 2006

ISBN 91-38-22594-8
ISSN 0375-250X

Summary

Introduction

The legal identity of an insurance undertaking in Sweden may be that of a limited liability insurance company, a mutual insurance company or a friendly society. The operations of insurance companies are regulated by the Insurance Business Act (1982:713), IBA, while the provisions relating to friendly societies are laid down in the Friendly Societies Act (1972:262), FSA. Both the IBA and the FSA contain incorporation law provisions as well as regulations on the specific operation of insurance undertakings. The incorporation law provisions in these acts differ on a number of points from the general provisions on incorporation laid down in the Swedish Companies Act (2005:551), SCA and the Co-operative Societies Act (1987:667), CSA.

Swedish limited liability insurance companies can either operate as dividend paying companies or on a mutual basis. The regulations for dividend paying limited liability insurance companies mean that the shareholders are responsible for the risk capital, on which they may receive a dividend, and also that there is a clear distinction between policyholders' funds and share capital. However, if a limited liability insurance company operates on a mutual basis, which only occurs in the life-assurance area, the entire surplus generated by its operation accrues to the policyholders. The consequence of this is that in principle it is the policyholders that provide the risk capital. Despite this state of affairs, influence over the operations of a limited liability insurance company operated on a mutual basis is vested almost entirely in its shareholders.

Policyholders in *mutual insurance companies* are both part-owners and customers and consequently companies of this kind should be operated entirely in the interests of the policyholders. The policyholders provide the company's risk capital and must be given the opportunity to affect its operations through either direct

or indirect voting rights at a general meeting. Similar provisions apply to friendly societies.

For a number of years amendments have been made to the regulations on the operation of insurance businesses to adapt them to the requirements of EU law and other changes in the circumstances in which they operate. These amendments have applied, for instance, to the management of insurance operations and their accounting. Legislation that came into effect on January 1, 2000, "the insurance business reform", involved considerable modernisation in this field. This reform, in which the focus was placed on regulations relating to life assurance undertakings, was intended to offer policyholders and the companies greater scope to agree themselves on the terms of policies and so enable product development and stimulate competition. Corresponding reforms have not been made in the legislation concerning friendly societies.

Harmonisation of the operational requirements with the European regulations, greater latitude for products and policies after the insurance business reform, the rapid growth in the financial markets and not least the major decline in the stock market at the beginning of the 21st century have highlighted the shortcomings in the largely obsolescent incorporation law provisions pertaining to insurance undertakings. These shortcomings have been particularly noticeable in the case of limited liability life assurance companies operated on a mutual basis and have resulted in serious impairment of confidence in life assurance companies.

In view of this background, the committee has been obliged to undertake a thoroughgoing review of the incorporation provisions that currently apply to Swedish insurance undertakings. Where the friendly societies are concerned, this review has also included the regulations relating to their operation.

The premises for the committee's consideration of incorporation law provisions

Special regulations will continue to apply to insurance undertakings in Sweden. These regulations will, in accordance with what has been determined in recent legislation relating to the area of insurance, be intended primarily to protect direct policyholders and also others entitled to claim against policies. As with other legislation in the financial area, the provisions relating to insurance undertakings

must be neutral from the point of view of the competitiveness of the corporate identities in which they operate. For this reason specific provisions must avoid unjustified distortion of competitiveness between different Swedish insurance undertakings and between those in Sweden and abroad. In addition the committee has been required to comply with the overriding goal for the regulation of financial operations, which is that it should focus on function. This means that regulation should concentrate less on special provisions for different groups of financial institutions and focus instead on the functions they provide, while however taking into account the underlying safeguards required for their operation.

In future the general legislation on incorporation law will provide the basic regulations for insurance undertakings. Therefore the new act will combine regulations about the operation of insurance undertakings with the specific incorporation requirements that apply in addition to or instead of those laid down in general incorporation law. The general provisions of incorporation law will apply by virtue of references in the new insurance business act. This new act will apply to all Swedish insurance undertakings. The current Insurance Business Act and the Friendly Societies Act can therefore be rescinded.

In determining the issue of which general incorporation law provisions are to provide the basis for an insurance undertaking, it would appear evident that the SCA is to apply for limited liability insurance companies and that the CSA is to apply for friendly societies. What is more uncertain is what incorporation provisions should apply to mutual insurance undertakings. The committee has however found manifestly overwhelming reasons for the application of the CSA. There are many similarities, both in Sweden and in many other countries, between the mutual form of incorporation and cooperative economic associations. On the other hand, a mutual insurance undertaking differs in essence from a limited liability company. The committee has therefore found it natural and also appropriate to find a basis for mutual insurance undertakings in legislation on associations.

Deviations from the general incorporation law provisions referred to may only be permitted if they are justifiable on the grounds of the special nature of the operations of insurance undertakings, to provide safeguards for policyholders and others entitled to claim on policies or the specific corporate nature of the

undertaking. Here, of course, the binding provisions in EU directives for insurers must be taken into account. Special regulations should be avoided as far as possible and only those for which there is very good justification may be permitted.

Life assurance in particular

The double role of policyholders in life assurance operations undertaken on a mutual basis has already been indicated. They have the role of creditors who may have a contractual claim by virtue of an insurance policy and also the role of providing the risk capital. The double role of the policyholders in a mutual insurance undertaking is the outcome of the form of incorporation. Where the limited liability insurance companies operated on a mutual basis are concerned, the double role is instead the result of legislation which could be described as involving encroachment on a fundamental feature of limited companies. In both mutual life assurance undertakings and in limited liability life assurance companies operated on a mutual basis, however, the policyholders normally have only little scope to exert influence on the risk capital. In mutual insurance undertakings this is because the power to make decisions at general meetings is normally vested in representatives who have not been appointed by the part-owners but by others. The importance of this lack of influence has greatly increased after the deregulation of recent years. Indeed, today the regulations and official supervision provide only limited safeguards for policyholders in their role of providing finance for the operation of the undertaking.

There are obvious corporate governance problems in a system that means that policyholders provide the risk capital without having any genuine possibilities of influence or oversight. In practice, the managements of a mutual life assurance undertaking or a limited liability life assurance company operated on a mutual basis are allowed a great deal of discretionary scope to act in ways that need not benefit the policyholders. The fundamental incentive for ownership control of a limited company is lacking when the owners cannot receive a dividend on the capital they have invested. The system in which the policyholders also contribute the risk capital has the additional drawback of providing the company with only limited possibilities of acquiring external finance. There is a risk that the problems referred to – complicated by the fact that

life assurance policies are often complex agreements that cover extended periods – may threaten the interests of the policyholders in different ways.

Even if the problem of the weakness of the position of policyholders in mutual insurance undertakings and in limited liability life assurance companies operated on a mutual basis may appear to be similar, the difference in the ownership situation in these undertakings militates against attempting to solve the problems in the same way.

The provision of jointly owned capital in a consolidation fund that may be written down to cover losses is in no way incompatible with the concept of mutuality and should therefore continue in mutual life-assurance undertakings. In the opinion of the committee, the position of the policyholders in undertakings of this kind should be strengthened and active owner governance encouraged by regulations that provide policyholders with genuine influence over the undertakings they jointly own.

To ensure that part-owners are able to make their voices heard at general meetings the committee is proposing that they themselves should appoint their representatives. In other words it will be impossible in future to include provisions in the articles of association enabling others, for instance stakeholder organisations, to nominate representatives unless they have been given such a mandate. A reform of this kind should be linked to more stringent requirements about the information provided to policyholders about their rights as part-owners. The committee also proposes extension of the scope for the provision of external capital in mutual life-assurance undertakings. However, infusions of capital of this kind must not come into conflict with the internationally accepted requirement that mutual undertakings may not be dependent on external stakeholders.

On the other hand, other approaches must be chosen for the limited liability life assurance companies operated on a mutual basis. Here, strengthening the influence of policyholders in a limited company would involve deviating from the fundamental principles on which such companies are based and would hardly offer any solution to the problems that arise. In the opinion of the committee the problems described above in limited liability life assurance companies operated on a mutual basis should be resolved either by the adoption of the regulations that apply to dividend paying companies or reincorporation in the form of a mutual insur-

ance undertaking. The transfer to dividend paying operation can be seen as a *demutualisation* process, but the conversion differs from the demutualisations that have taken place in other countries in that the companies are already limited liability companies and not mutual companies.

The demutualisation would, according to the restructuring regulations in force today, require crediting the policyholders and others entitled to make claims against policies with all the risk capital that can be considered to belong to them as a bonus to be booked as part of the technical provisions. These regulations would in some cases require such a large infusion of capital by the owners in the process of demutualisation that it is not always possible to comply with them. In view of this, the committee has found it necessary to propose alternative procedures for demutualisation. This could, for instance, be arranged by transforming the policy holders' capital into share capital and issuing new shares to the policyholders and others entitled to claim, either individually or collectively. These shares could be listed in some market or redeemed by the company when a claim is made pursuant to a redemption provision in the articles of association. Another possible arrangement could involve transforming the policy holders' capital into equity-linked loans issued to the policyholders and others entitled to claim. In every case care should be taken to ensure that the transfer does not lead to taxation effects for those entitled to payment.

Reincorporation as a mutual undertaking is to take place in accordance with the current regulations that apply to the formation of mutual insurance undertakings and transfer of the insurance portfolios.

No credits may be assigned on demutualisation or reincorporation as a mutual insurance undertaking without the permission of the Swedish Financial Supervisory Authority (Finansinspektionen). This permission may only be granted if it can be presumed that this crediting procedure will not impair the rights of policyholders and others entitled to claim against policies.

All transfers should have been implemented within three years of the date on which the new legislation comes into effect. Applications for permission to demutualise or to reincorporate as a mutual insurance undertaking should therefore be submitted to the Swedish Financial Supervisory Authority no later than two years after the legislation comes into force.

Specific regulations for the incorporation of limited liability insurance companies

As can be seen from the above, the general regulations relating to limited liability companies will provide the basis for the incorporation of limited liability insurance companies.

In appraising the necessity of introducing regulations that differ from the Swedish Companies Act, the committee has been able to refer to the assessments that were made in connection with the extension of general company law in 1999 to cover limited liability banking companies. A large number of the specific provisions that were then rescinded or incorporated into other legislation have their counterparts in the IBA. Moreover, in several cases the regulations in the banking and insurance areas were based on identical or very similar grounds. In view of these circumstances and the fact that experiences so far of the banking reform referred to seem to have been positive, the committee has adopted the standpoint that the assessments made in connection with the 1999 banking reform should only be disregarded if a specific regulation can be justified for reasons other than those which are in principle shared by banking and insurance operations.

The committee has also been able to find support in the memorandum on new incorporation law for insurance undertakings and others presented by the Ministry of Finance in 1998. This memorandum offered a thorough survey of the incorporation law provisions that applied to insurance undertakings and also proposed amendments. The premises on which this review was based were in total accord with those that applied for the work of this Committee on Insurance Undertakings in Sweden. Consequently it has been possible to endorse the vast majority of the assessments made in the 1998 memorandum.

Among the incorporation law provisions relating to limited liability insurance companies for which the committee has found justification can be mentioned the stipulation that share capital must be determined with regard to the extent and nature of the planned operations, that the articles of association must contain certain additional information, that stringent requirements must apply to management and auditors as well as the regulations prohibiting the provision of services to certain disqualified individuals. In addition, it also proposes, for instance, specific regulations on procedures for the reduction of share capital or

reserve funds, for mergers or splits and also for liquidation and bankruptcy.

Specific regulations for the incorporation of mutual insurance undertakings

In appraising the need for specific incorporation law provisions for mutual insurance undertakings the committee could not, as it could in the case of limited liability insurance companies, find guidance in reforms in other areas of legislation.

In addition to the specific regulations applying to insurance undertakings in general that may be required, specific regulations may be justifiable for mutual insurance undertakings because of their particular corporate form. Otherwise mutual insurance undertakings should not be treated differently from limited liability insurance companies. In determining the necessity for specific regulations for mutual insurance undertakings the committee has therefore often been able to concur with the assessments made for limited liability insurance companies. When there is substantial similarity between regulations in the SCA and the CSA, a specific provision that applies to mutual insurance undertakings rather than limited liability insurance companies can only be justified by the distinct features of mutual undertakings.

The committee has found that several specific provisions are needed for mutual insurance undertakings. Ownership will continue to be vested in the direct policyholders and, in some cases, those insured while the personal liability of the part-owners through the possibility to call up additional contributions may only be invoked in non-life insurance operations. The current regulations on the establishment of mutual insurance undertakings and the articles of association for such undertakings will be retained more or less unchanged. A new stipulation will be introduced about the amount of guarantee capital required to correspond to the share capital requirement for limited liability insurance companies. Mutual insurance undertakings will be able to receive subordinated debentures but not in excess of the amount corresponding to their own capital. Neither members' contributions nor fees will be allowed in the future either. Like limited liability insurance companies, stringent requirements will apply to the management and auditors of mutual undertakings. The stipula-

tion laid down for mutual life-assurance undertakings referred to above that representatives at general meetings may only be appointed by part-owners will apply to all mutual insurance undertakings. Mutual insurance undertakings will, like limited liability insurance companies, apply regulations prohibiting the provision of services to certain disqualified individuals. A number of specific regulations on procedures in the case of mergers or liquidation will apply to mutual insurance undertakings.

New regulations for friendly societies

In accordance with what must be considered implicit in the committee's directives, the provision of insurance through some form of society will continue to be possible in the future. However, the societies that will operate in the insurance area alongside the limited liability insurance companies and the mutual insurance undertakings will from now on be called insurance societies (försäkringsföreningar) instead of friendly societies (understödsföreningar), as they are called today.

As has already been indicated, the CSA is to apply to insurance societies as it does to mutual insurance undertakings. As a result of the similarity of the principles on which both forms of incorporation are based, the special regulations for the two will be similar. Only a few incorporation law provisions that apply for mutual insurance undertakings will not apply to insurance societies and vice versa.

In the field of regulation of insurance operations, specific regulations for insurance societies vis à vis those that apply to insurance undertakings may only exist if they can be justified by the specific features of the insurance societies or by EU requirements.

The adoption of these premises requires harmonisation of the regulations for insurance societies with those that apply to insurance undertakings. For instance the areas in which societies may operate will be extended: in future they will be able to offer all forms of direct life-assurance. Where non-life insurance is concerned, however, as has been the case up to now, their operation will be restricted to direct sickness and accident insurance. The current prohibition against commercial insurance operations will no longer apply, nor will there be any limit to the insurable

amounts for certain policies. In addition insurance societies will be allowed to opt to be open or closed. The current principles concerning demand, solidity, fairness and soundness will be abolished and replaced by the operative requirements that apply to insurance undertakings, above all the basic principles of stability, transparency and sound insurance standards. Another important change is that in the case of bankruptcy of an insurance society special priority will apply to claims made on policies.

The new regulations may involve time-consuming adaptation for certain insurance societies. The societies will therefore be allowed a two-year transition period in which to take the measures required.

Specific regulations for small insurance undertakings

The task of the committee also included an analysis of the need for specific regulations for small mutual insurance undertakings and small insurance societies. Here the committee has found that special provisions for small insurance undertakings are often prevented by the regulations in the EU insurance directives. These directives mean that specific regulations can be laid down primarily for mutual non-life insurance operations, where the articles of association permit the calling up of additional contributions from members, and for burial societies.

It is the committee's opinion that fewer safeguards are required in many small insurance undertakings: the amounts insured in these undertakings are often modest. This state of affairs combined with the fact that supervisory resources are restricted justifies special treatment of the small insurance undertakings. Special treatment should take place after an exemption process. An overall appraisal should be made to determine whether exemption is possible and, if so, how far-reaching the waivers should be. The waivers made for small insurance undertakings should primarily concern the regulations covering insurance operation but sometimes also the special incorporation law provisions in the new Insurance Business Act. It goes without saying that no waiver may conflict with Sweden's undertakings in the EU.

Coming into force – and transitional regulations

In view of the urgent need for modernisation of the regulations on Swedish insurance undertakings the new Insurance Business Act should take effect as soon as possible. The committee has concluded that January 1, 2008 would be an appropriate date. The transition from the previous regulations to the new act will, however, require a number of transitional regulations in addition to those referred to here. For instance, permits that have already been issued for insurance operations must continue to apply, and exemption from provisions in the IBA and FSA granted previously must apply for the corresponding provisions in the new act.