

# MARKET BULLETIN

REF: Y4044

<b>Title</b>	The Law on Mediation of Private Insurance and Reinsurance (Law 26/2006)
<b>Purpose</b>	To explain the ramifications for Lloyd's of the law implementing the Insurance Mediation Directive in Spain
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<b>Deadline</b>	None

The Spanish Law on Mediation of Private Insurance and Reinsurance (Law 26/2006) – implementing the Insurance Mediation Directive (“IMD”) in Spain - came into force on 19 July 2006. The new law has a number of practical implications for Lloyd's and in particular in respect of coverholder arrangements.

The new law could be interpreted in a manner which would limit managing agents' ability to continue to access Spanish business through coverholders. Given the importance of this distribution network to the Lloyd's market, Lloyd's has been engaged in lengthy and detailed discussions with the Spanish regulator, the DGS, to ensure that managing agents can continue to access Spanish business through their coverholders, but in a manner that is compatible with the new law.

We also have sought related guidance from the FSA to ensure that dealing with Spanish coverholders does not bring the Lloyd's market into conflict with the FSA's rules.

As a result of the discussions we have held we are able to advise the following key developments:-

1. The DGS has now issued public guidance to clarify Lloyd's key concerns and that confirms that Lloyd's managing agents may continue to use this important distribution network. Importantly the note recognises the subscription basis of Lloyd's business<sup>1</sup>.

<sup>1</sup> This guidance is available at [www.dgsfp.mineco.es/profesionales/documentos/Agencias%20suscripción.pdf](http://www.dgsfp.mineco.es/profesionales/documentos/Agencias%20suscripción.pdf) and an English free translation is available from Lloyd's International Access Market/Lloyd's Spain.

2. Nevertheless, the new Spanish law and the accompanying guidance issued by the DGS do have some important new implications for Spanish coverholders and Lloyd's managing agents dealing with those coverholders. In particular, the new law imposes certain key restrictions on the activities of Spanish coverholders.

3. The new law also has the effect of regulating the different types of distribution structures through which Spanish coverholders can access business; this is especially relevant where the coverholder is acting in a "wholesale" capacity. To help managing agents establish the necessary contractual frameworks Lloyd's has commissioned the production of a suite of model wordings for different distribution arrangements.

4. Lloyd's has also agreed with the DGS that Lloyd's Spain will co-ordinate the provision of information to the DGS regarding binding authorities held by both Spanish and non-Spanish coverholders. This will assist in reducing administrative burdens for managing agents and coverholders.

5. The FSA has provided helpful guidance regarding the effect of MIPRU<sup>2</sup> where managing agents are dealing with entities that are not regarded by their home state as insurance intermediaries. This is important as Spanish coverholders (as "underwriting agencies") are not treated under the new law as insurance intermediaries and as such are not directly regulated. In practical terms, applying the FSA's guidance in the context of Spanish business, managing agents should not breach the provisions in MIPRU when they deal with Spanish coverholders.

### **Lloyd's guidance note**

These issues are discussed in greater detail in the attached note and it is therefore important that managing agents read the note if they intend to continue to access Spanish business through both Spanish and non-Spanish coverholders. The note covers the following in particular:-

- the background to the new Spanish law and the approach the DGS has taken;
- how Spanish coverholders can act on a wholesale basis and the various obligations that attach to managing agents when dealing with the different types of legal entities in Spain;
- the associated FSA rules and passporting issues.

### **Further information**

As will be apparent the implementation of the Spanish law raises a number of complex issues, not all of which have at this time been clarified. Accordingly in the event that you have any specific queries relating to the new Spanish Law, or are thinking of undertaking

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<sup>2</sup> As contained in the FSA Handbook (MIPRU); The Prudential Sourcebook for mortgage and home finance firms and insurance intermediaries.

Spanish business through either Spanish or non-Spanish coverholders, you are encouraged to contact Lloyd's Spain on +34 91 426 2312.

This bulletin has been sent to all managing agents, Lloyd's brokers and Spanish coverholders.

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## Note on the Spanish Law on Mediation of Private Insurance and Reinsurance (Law 26/2006) and its impact on coverholder arrangements

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### 1. Background to the law

1.1 At the time that the Spanish authorities were preparing the new Spanish law to implement the IMD, the DGS made clear two important points that are relevant to Lloyd's coverholder arrangements -

- i. a broker cannot act as a coverholder; and
- ii. a coverholder in Spain is regarded as an "underwriting agency"<sup>3</sup>.

1.2 The new law came into force in July 2006 and provided that only brokers or insurance agents<sup>4</sup> (which can be either "exclusive" or "tied" agents) are considered to be insurance intermediaries. Underwriting agencies (ie coverholders) are expressly not considered as intermediaries. This of course contrasts with the position elsewhere in the EU, including the UK.

1.3 Although the law is now in force a number of issues have needed to be clarified, in particular as the law has limited express provisions that relate to underwriting agencies. Accordingly, the DGS has continued to consult and discuss the implications of the law. This note reflects the outcome of Lloyd's discussions with the DGS to-date. It is likely, however, that further implications of the law will become clearer over time and so we will continue to monitor relevant developments.

### 2. Underwriting Agencies

2.1 An "underwriting agency" is not regarded in Spain as an insurance intermediary and its activities are not regarded as insurance intermediation. Spanish law regards an underwriting agency as a direct distribution channel of the insurer. In consequence the activities of the underwriting agency are deemed to have been performed by the insurer directly and the DGS does not approve/regulate underwriting agencies. This has certain important consequences.

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<sup>3</sup> An "underwriting agency" is an entity that accepts and underwrites risks on behalf of an insurer. Other tasks may also be performed by underwriting agencies such as signing contracts of insurance, collecting premiums and handling claims.

<sup>4</sup> An "insurance agent" is defined as an individual or an entity which, through an agency agreement with one or more insurers, carries out intermediation activities (introducing, proposing or carrying out other work proprietary to the conclusion of contracts of insurance or of concluding such contracts, or assisting in the administration of such contracts, in particular in the event of a claim).

*Incompatibility with being a broker*

- 2.2 The DGS has stated consistently that the activities of being a broker are incompatible with those of being an underwriting agency. For this reason Lloyd's wrote to all Lloyd's Spanish coverholders on 20 July 2006 advising them that, where they were currently undertaking broking activities, they would need to establish a separate legal entity - an underwriting agency - to be able to continue to perform the coverholder activities.
- 2.3 In addition, the DGS has said that staff (including directors and general representatives) who perform key functions at a broking firm will no longer be able to be a director or officer in an underwriting agency. Therefore, all Spanish coverholders who have a related broking firm need to ensure that there is separate management between the two firms.
- 2.4 The DGS has also stated that if a broker (either individual or company) intends to hold a significant shareholding link with an underwriting agency (over 10%) then the broker needs to obtain the prior consent of the DGS. (In the case of existing shareholder connections between brokers and underwriting agencies, the broker needs to notify the DGS of that relationship as soon as possible).

*Exclusivity*

- 2.5 A further implication of underwriting agencies being regarded as a "direct distribution mechanism" for an insurer is that an underwriting agency may only have one principal (i.e. may only act for one (re)insurer). Lloyd's was concerned that this could have been interpreted such that a coverholder could only act exclusively for a single Lloyd's managing agent/syndicate.
- 2.6 We are therefore pleased that the DGS has now confirmed that for the purposes of the new law "the association of underwriters known as Lloyd's" is to be regarded collectively<sup>5</sup> and that therefore more than one Lloyd's syndicate can appoint an underwriting agency (especially important where a binding authority is subscribed to by several syndicates). In addition, any managing agent can appoint multiple Spanish underwriting agencies (i.e. can have more than one Spanish coverholder).
- 2.7 However, the DGS has also made it clear that a Lloyd's Spanish coverholder may not then also act for a non-Lloyd's insurer. This means it cannot hold a binding authority with mixed Lloyd's and non-Lloyd's security.

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<sup>5</sup> This is notwithstanding the subscription nature of the market and that Lloyd's underwriters have several liability for risks underwritten.

*Information requirements*

- 2.8 Although underwriting agencies are not subject to regulatory approval by the DGS, the law nevertheless requires the DGS to be notified of the terms of an appointment of an underwriting agency and also when the appointment is terminated. Lloyd's has agreed with the DGS that Lloyd's Spain will be the single channel for the submission of binding authority details of Lloyd's Spanish underwriting agencies.

**3. Duties and obligations of managing agents when they appoint an "underwriting agency"**

- 3.1 When a managing agent is considering whether to appoint a Spanish underwriting agency it should be aware that it will be fully responsible for all liabilities arising from the activity carried out by that underwriting agency (this includes the obligations to the Spanish regulator and any obligations to third parties). The concept of "ostensible authority" applies in Spain, so the acts of a coverholder acting under the ostensible authority of its principal will be binding on the principal, even if the coverholder is acting ultra vires (ie outside the limits of its actual authority).
- 3.2 In order to manage the risks, managing agents should ensure that an appropriate binding authority is granted to the coverholder that clearly sets out the duties and responsibilities of the coverholder and should ensure that the activities are carefully monitored. In addition, managing agents will need to comply with the relevant duties set out in Annex 1.

**4. Underwriting agencies acting on a wholesale basis**

- 4.1 Coverholders may operate on either a "retail" basis, dealing directly with policyholders, or on a "wholesale" basis, accepting business introduced by intermediaries. The new Spanish law has important implications where it is intended that a Spanish coverholder (who is an underwriting agency) wishes to act on a wholesale basis.
- 4.2 A wholesale Spanish coverholder may accept business produced to it from (i) a broker or (ii) an insurance agent. The relevant considerations are set out below.

*Broker*

- 4.3 A Spanish coverholder may access business produced to it by a registered Spanish broker. In order to develop this relationship the underwriting agency may enter into "letters of terms" to brokers (i.e. a terms of business agreement) to set out the relevant requirements of transparency and independence, although this is not compulsory.

*Insurance agent*

- 4.4 As a Spanish coverholder is not an insurer, the DGS has made it clear that an underwriting agency may not itself enter into an agency agreement with an insurance agent for the insurance agent to produce business into the underwriting agency. In other words, a Spanish coverholder may not appoint its own insurance agents.
- 4.5 Lloyd's has discussed this with the DGS who agree that a solution is for the Lloyd's managing agent, underwriting agency and insurance agent to enter into a "tripartite agreement". This means an agreement in which the managing agent directly appoints the insurance agent, but which also makes clear that the tasks of underwriting risks will be carried out by the underwriting agency.
- 4.6 A managing agent wishing to enter into such an agreement should be aware of the obligations that will attach to it by appointing an insurance agent. These obligations vary depending upon whether the insurance agent is an "exclusive" or "tied" agent<sup>6</sup>. Annex 1 sets out some of the key obligations and duties that will apply.

*Model wordings*

- 4.7 Where a Spanish coverholder is to act on a wholesale basis for risks produced to it by either an exclusive or tied insurance agent, it will be important that an appropriate tripartite agreement is entered into between the various parties. To this end Lloyd's has commissioned Davies Arnold Cooper to prepare model tripartite agreements for use in Spain. These can be made available to managing agents and Lloyd's brokers upon request to Lloyd's Spain. Nevertheless, in all cases, managing agents will need to take into account the obligations that appointing these various entities will entail and will also need to adapt the model wording as appropriate for their specific business requirements.
- 4.8 Please note that Lloyd's Spain must be provided with a copy of each agency agreement entered into.

**5. Approach of the FSA***Application of MIPRU*

- 5.1 It is expected that most Spanish coverholders will be underwriting agencies and so will not be regulated by the DGS<sup>7</sup>. It has therefore been important to check that

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<sup>6</sup> An "exclusive agent" can only act for one insurer and if that insurer so authorises on behalf of other insurers for different types of business. A "tied agent" can act for several insurers each of which must hold separate agency agreements with the agent.

<sup>7</sup> It may be theoretically possible for a managing agent to appoint an insurance agent as a coverholder (although this is not the approach the DGS has taken and there would be practical issues in appointing an insurance agent

dealing with such an unregulated entity would not constitute a breach of FSA rules contained in MIPRU 5 (on the basis that Lloyd's underwriters would be dealing with unregulated intermediaries). FSA have now provided Lloyd's with certain guidance regarding the application of MIPRU which we believe provides the necessary comfort.

- 5.2 It would be a breach of FSA's rules (MIPRU 5.2.1R) if a UK firm used, or proposed to use, the services of another person who was carrying out "*insurance mediation*" or an "*insurance mediation activity*", unless the other person had itself the relevant permission, was exempt from authorisation or was registered in another EEA state for the purposes of the IMD<sup>8</sup>. However, FSA have pointed out that –
- a person would only be deemed to be carrying out "*insurance mediation activity*" if they were carrying on that activity in the United Kingdom<sup>9</sup>; and
  - whether an overseas entity is carrying on a "*insurance mediation*" depends upon whether the relevant home state regulator would regard the entity as carrying on an "*insurance mediation*" within the meaning of the IMD.
- 5.3 Applying this guidance in the context of a Spanish underwriting agency; Lloyd's understands that, assuming that it is not conducting business in the UK and given that the DGS does not regard an underwriting agency as conducting insurance mediation, then it should not be a breach of FSA's rules for Lloyd's underwriters to deal with an underwriting agency.

#### *Passporting issues*

- 5.4 The FSA has made it clear that where a person has not been registered under the IMD they cannot exercise passporting rights under the IMD. Therefore, a Spanish underwriting agency could not passport into the UK but would need to seek FSA authorisation.
- 5.5 *(Please note that section 5 above does not constitute formal FSA guidance but is provided by Lloyd's to assist managing agents; also that compliance with FSA's rules, including MIPRU, is ultimately a matter for the relevant managing agent).*

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as a coverholder). But if an insurance agent was appointed as a coverholder it would be subject to DGS authorisation as an insurance intermediary and so there should not be an issue with compliance with these provisions in MIPRU.

<sup>8</sup> See MIPRU 5.2 for full details of the relevant requirements

<sup>9</sup> See Financial Services and Markets Act 2000 (Section 418) which extends the meaning of "in the United Kingdom" for these purposes.

**6. Non-Spanish coverholders**

- 6.1 Managing agents may continue to accept Spanish risks through non-Spanish coverholders. In most member states the coverholder will be regulated as an insurance intermediary. Accordingly the DGS has agreed that such a coverholder may be passported into Spain.

*Information requirements*

- 6.2 The non-Spanish coverholder will need to register with the DGS the scope of its binding authority before it accepts risks. Managing agents/coverholders may either make the notification directly or may ask Lloyd's Spain to make the notification on their behalf. However, in all cases Lloyd's Spain should be notified where a non-Spanish coverholder intends to accept Spanish risks.

*Use of local distribution networks*

- 6.3 The non-Spanish coverholder may enter into a "terms of business agreement" with a Spanish broker (or with an "external auxiliary" which acts as a form of introducer). However, the non-Spanish coverholder may not appoint insurance agents in Spain.

## Annex 1

### Obligations and duties on managing agents when they appoint (a) underwriting agencies and (b) insurance agents (exclusive or tied)

#### 1. Underwriting agencies

- **Registration of the binder with the DGS** – managing agents are responsible for ensuring that the underwriting agency to which they have delegated their authority in accordance with the terms of a binding authority has been registered with the DGS. However, in order to reduce the administrative burden, Lloyd’s has agreed with the DGS that Lloyd’s Spain will be the single channel for the submission of Lloyd’s Spanish underwriting agency binding authorities.
- **Transparency and publicity** – managing agents should ensure that an underwriting agency discloses in documentation it provides to policyholders the fact that it is an “underwriting agency” and should identify the relevant Lloyd’s managing agent/syndicate. Pro-forma versions of the insurance documentation that the coverholder will issue must be provided in advance to Lloyd’s Spain for it to ensure this obligation has been met.
- **Exclusivity** - a Spanish coverholder/underwriting agency may only act exclusively for Lloyd’s. Therefore managing agents should ensure that their Spanish coverholders do not act for any non-Lloyd’s insurers. Lloyd’s Spain requires that a standard exclusivity clause be included in the binding authority for a Spanish coverholder. The model wording is available from Lloyd’s Spain.
- **Prohibition on acting as an insurer** – managing agents must take necessary steps to ensure that the underwriting agency is not itself seen to be acting as the insurer. It must make clear to policyholders that it may only bind risks for and on behalf of the relevant Lloyd’s syndicates. When dealing with coverholder applications, Lloyd’s Spain will ask for a copy of the model policy wording to check whether it contains a clear definition of who is assuming the risk and who is acting on behalf of the insurer.
- **Incompatibility with being a broker** – managing agents must make sure that they are satisfied that the coverholder is not acting as a broker and check that the directors/managers of the coverholders are not also directors/managers of a broker. Lloyd’s Spain will also check this matter when dealing with coverholder applications.
- **Shareholdings of brokers in coverholders** – managing agents must make sure that, if any broker holds more than 10% of the shareholding of an underwriting agency, the coverholder has obtained the necessary prior consent of the DGS. Lloyd’s Spain will again check this matter when dealing with coverholder applications.
- **Prohibition on underwriting agencies appointing insurance agents** – an underwriting agency has no authority to appoint insurance agents to produce business

into it. This is particularly important where the coverholder intends to act in a “wholesale” capacity. Accordingly, the guidance set out below at section 4 of this note should be carefully followed.

## 2. All insurance agents

- **Entry into a written agency agreement** – managing agents must comply with relevant provisions in the law and in the Agency Contracts Act No 12/1992 of 27 May. The contract must also provide for remuneration of agents. The agency agreement must be subject to Spanish Law.
- **Notification of termination of an agency agreement** – managing agents must notify every policyholder of the termination of an agency agreement and the appointment of any new agent.
- **Liability for agents’ outstanding debts with another/previous insurer** – managing agents will be obliged to meet any debts owed by an insurance agent to any other / previous insurer in respect of business intermediated by the agent.
- **Receipt of policyholders’ notifications** – managing agents will be deemed to have received any notification made by the policyholder to the agent.

## 3. Exclusive agent (obligations in addition to 2 above)

- **Liability for wrongdoings of exclusive agents** – managing agents are directly liable for any professional liability incurred by an exclusive agent.
- **Registration of exclusive agents** – managing agents must create and maintain an internal register of exclusive agents containing certain mandatory information. In addition, Lloyd’s Spain will also keep a register of exclusive agents.
- **Notification to the DGS** – The Law provides that any insurer appointing exclusive agents must provide information on those agents to the DGS and ensure that all such information held by the DGS is up-to-date. In order to reduce the administrative burden, Lloyd’s Spain will discharge this obligation. It is therefore crucial that Lloyd’s managing agents (either directly or through the Lloyd’s broker/Spanish coverholder) provide a copy of the agency agreement to Lloyd’s Spain.
- **Verification of knowledge, ability and good repute** – managing agents should check, prior to entering into an agency agreement with an exclusive agent, that at least half of the management team of the agent have the requisite knowledge and ability to perform their duties and that the agent is of good repute.

- **Client money rules** – sums paid by the policyholder/insured to an exclusive agent are deemed to have been paid to the managing agent. However, sums paid by the managing agent to the exclusive agent are not deemed to have been paid to the client.
- **Training** – managing agents must take all necessary steps to train exclusive agents.
- **Incompatibilities of exclusive agents** – an exclusive agent may not act as a tied agent/broker/external auxiliary/loss adjuster.
- **Transparency and publicity** – exclusive agents are required to indicate in all publicity and commercial documentation their status as a Lloyd's exclusive agent and their registration number.
- **Client protection information** – managing agents are responsible for ensuring that policyholders receive certain mandatory contractual information.
- **Appointment of external auxiliaries** – an insurance agent may appoint external auxiliaries but they must not carry out insurance mediation activities. The terms and conditions of the appointment of an exclusive agent must be previously agreed with the Lloyd's managing agent in the agency agreement.

#### 4. Tied agents (obligations in addition to 2. above)

- **Liability** – managing agents are not liable to the Spanish regulators for the wrongdoings of a tied agent. The tied agent is directly responsible for such infringements.
- **Training programme for tied agents** – this is the responsibility of the tied agent alone and not the Lloyd's managing agent. However, Lloyd's managing agents must prepare training programmes for their tied agents in respect of the specific insurance products intermediated by those tied agents.
- **Client money rules** – tied agents must have financial provision of not less than 4% of terminal annual premiums. Managing agents may expressly agree to waive this if the agency agreement allows for premiums to be paid by policyholders through direct debits directly into an account opened in the name of the relevant Lloyd's underwriters, or if the tied agent offers the policyholder immediate cover.

*The above is provided for information purposes only to outline some of the areas that a managing agent would need to consider when deciding whether to enter into an agency agreement. The above does not purport to set out the specific obligations/rules and further details can be obtained from Lloyd's Spain or from managing agents' legal advisors.*