ARTICLE

Gibraltar Insolvency Regime for Insurance Companies

Nigel Feetham, Partner, Hassans, Gibraltar

Introduction

Gibraltar is part of the EU by virtue of UK membership pursuant to Article 227(4) of the Treaty of Rome. A legal practitioner in England and Wales will find a familiar insolvency environment in this jurisdiction: the insurance legislation incorporates the relevant EU directives and is almost identical to the Insurance Companies Act of England, the main insolvency provisions in the Companies Ordinance are very similar if not identical to those in the Companies Act 1929 of England, with subsequent modifications and amendments, and, although judicial authorities in England and Wales are not binding in Gibraltar, they are highly persuasive, particularly when based on equivalent UK statutory provisions.

The status of Gibraltar in the European Union

Gibraltar's status in the European Union can be described as follows:

> "Gibraltar is a dependent territory of the United Kingdom with a separate constitution granted to it by the British Parliament. The Government of Gibraltar exercises self government except in matters of defence, internal security and foreign affairs which are reserved to the UK. Gibraltar laws are promulgated by its own elected parliament (House of Assembly).
>
> Gibraltar entered the EU together with the UK upon its accession in 1973. It is a European territory for whose external arrangements a Member State (UK) is responsible ...
>
> Article 28 of the UK Accession Act provides that there shall be certain exceptions from Community measures with respect to Gibraltar, i.e. the Common Agricultural Policy, VAT and the Common Customs Tariff do not apply. Subject to these explicit exceptions, all legislation adopted by the Community since 1973 has been applicable to Gibraltar ... [and all applicable Directives have been transposed].
>
> ... [it is not] a separate Member State ... [but] it is none the less a separate legal jurisdiction for the purpose of Government legislation and judicial authority ..."[1]

Broadly speaking, Gibraltar law follows English principles of law and EU Directives tend to be enacted in Gibraltar as they are in the UK (the Member State responsible for Gibraltar), although often later, in view of the pressure on the local administration to process them.

Gibraltar regulatory environment

Since 1997 significant progress has been made for Gibraltar's legislative and regulatory regime in insurance to match that in the UK. The Insurance Companies Ordinance 1987 (as amended) and its subsidiary legislation regulate the conduct of insurance business in Gibraltar. The Commissioner of Insurance, who is the insurance regulator, and the Financial Services Commission are responsible for its implementation. The terms of the legislation, both primary and subsidiary, are based substantially on the Insurance Companies Act. Gibraltar has therefore implemented EU Insurance Directives in a manner almost identical to the UK, and, in particular, insurance companies incorporated in Gibraltar are subject to a supervisory regime intended to match UK standards of supervision.

On 11 June 1997, following an audit by the UK Review Team, the UK confirmed that Gibraltar's supervisory regime for insurance matched the standards of supervision in place in the United Kingdom. As a result, insurers licensed in Gibraltar became entitled to cover risks in Member States without being obliged to seek a separate licence. This has resulted in a substantial increase in the number of insurance companies licensed in Gibraltar and now writing

Notes

1 Government of Gibraltar website.

business across the EU[2]. The insurance "passport" applies throughout Member States[3] and in relation to the UK extends to Gibraltar as if it were an EEA State by virtue of The Financial Services and Markets Act 2000 (Gibraltar) Order 2001(SI 2001/3084). Gibraltar is therefore treated by the UK as if it were an EEA State with regard to the use of the insurance "passport" by Gibraltar insurers.

The insurers do so under the watchful eye of the regulators in Gibraltar. Whilst insolvency in the insurance sector is the last thing in the mind of the industry, it is a challenge the industry may face in the future. In this respect, it must be said that regulators keep a close supervision over insurance companies to prevent insolvency by early intervention, and, so far, there have been no insolvencies under the new regulatory regime. In particular, under Section 100 of the ICO the Commissioner of Insurance may issue to an insurance company such directions in writing as he may consider necessary for the purposes of protecting policyholders or potential policyholders of an insurer against the risk that the insurer may be unable to meet its liability and for the purpose of ensuring that the criteria of sound and prudent management are fulfilled in respect of the insurer.

Solvency requirements

An insurance company must meet minimum solvency requirements. The solvency margin requirements are based on the EU Insurance Directives. The Commissioner of Insurance will make an evaluation of all the risks expected to be borne by the insurance company and may frequently impose a solvency margin requirement higher than the minimum.

Companies incorporated under Gibraltar law

Sources of law

The procedures for dealing with insolvent insurance companies in Gibraltar (and solvent companies that wish to undertake a formal structuring of their debt) are set out in the Insurance Companies Act (the "ICO"), Companies Ordinance (the "CO") and the Companies (Winding-up) Rules 1929, as amended. The Companies Ordinance provides procedures that may be entered into by solvent and insolvent companies generally, including liquidations (Part V of the CO) and a procedure whereby a company can enter into a binding compromise or "scheme" of arrangement with its creditors (Section 145 of the CO). The legislation does not make provision for corporate voluntary arrangements or administration orders, unlike the English legislation. The Companies Ordinance also makes provision for voluntary winding-up under the supervision of the court, a procedure which no longer exists in England.

There has as yet been no case-law on the winding-up of insurance companies in Gibraltar, but given that Gibraltar largely follows English insolvency legislation, local insolvency practitioners and regulators know that if such a case arose they would be navigating chartered waters.

Liquidation

Types of winding-up

The winding-up of a company under the general corporate law may be either (a) by the court; (b) voluntary; or (c) subject to the supervision of the court. In theory it would be possible to have an insurance company wound up under any of these procedures. However, Section 283(1)(a) ICO provides that in the case of a company incorporated in Gibraltar and carrying on long-term business, there can be no voluntary winding-up. It should also be noted that a winding-up which is voluntary or subject to supervision is ruled out in relation to foreign-registered companies generally.

Under Section 156 CO states that:

"A company may be wound up by the court if:

(a) the company has by special resolution resolved that the company be wound up by the court;
(b) default is made in delivering the statutory report to the Registrar or in the holding of a statutory meeting;
(c) the company does not commence its business within a year from its incorporation, or suspends its business for a whole year;
(d) the number of members is reduced, in the case of a private company, below one, or, in the case of any other company seven;
(e) the company is unable to pay its debts;
(f) the court is of the opinion that it is just and equitable that the company be wound up."

Typically, a petition to wound up a company is presented if the company is unable to pay its debts. Under Section 157 CO a company is unable to pay its debts if:

Notes

2 The number of Gibraltar licensed insurance companies has increased from 13 in March 2000 to 31 and it is projected to triple from the 2000 level by the end of 2003.

3 Financial Services Commission website.

© 2004 Chase Cambria Publishing

"(a) a creditor, by assignment or otherwise, to whom the company is indebted in a sum exceeding £500 then due, has served on the company by leaving it at the registered office of the company, a demand under his hand requiring the company to pay the sum so due, and the company has for three weeks thereafter neglected to pay the sum, or to secure or compound for it to the reasonable satisfaction of the creditor; or

(b) if execution or other process issued on a judgment, decree or order of any court in favour of a creditor of the company is returned unsatisfied in whole or in part; or

(c) if it is proved to the satisfaction of the court that the company is unable to pay its debts, and, in determining whether a company is unable to pay its debts, the court shall take into account the contingent and prospective liabilities of the company."

Thus a petition for the winding-up of a company may be made by either the company, or any creditor or creditors (including any contingent or prospective creditors), contributory or contributories together or separately in accordance with Section 158.

The UK provisions in the Insurance Companies Act relating to creditors are similar to those under Gibraltar law. However, it is the Commissioner of Insurance (with the leave of the court) rather than the UK Secretary of State who may present a winding-up petition on a variety of grounds (Section 120 ICO; Schedule 8, paragraph 2 ICO).

Similarly, the "special statutory feature", which governs how ten or more policyholders may wind up a company, applies in Gibraltar, although each individual must hold policies amounting to at least £100,000 (ibid.).

It should be noted that a company need only fail to satisfy a demand for a sum of £500 before it is deemed to be unable to pay its debts; but this is unlikely to be an issue provoking a winding-up order in the case of an insurance company. In other respects, the Gibraltar law follows the UK and on the hearing of the winding-up petition the court may make any order that it thinks fit including dismissing or adjourning the petition (Section 159(1) CO). Winding-up would be appropriate where the insurance company was helplessly insolvent and there was no prospect of the company being placed in "run off" through the implementation of a scheme of arrangement.

Unless otherwise ordered by the court, the liquidator must continue the company's long-term business (either him- or herself, or through a 'special manager') with a view to transferring it to another insurance company, but cannot enter into new contracts (Section 120 ICO; Schedule 8, paragraph 7 ICO). The Court can, on the liquidator's application, appoint a special manager for long-term business, and can appoint an independent actuary, if so requested by the liquidator, the special manager, or the Commissioner of Insurance (ibid.).

Proof of claims

The UK provisions for the proof of claims against insurance companies are much more detailed than the Gibraltar equivalents. In the main a creditor must prove in the ordinary way under the CO. However, where a liquidator is winding-up a company which undertakes both long-term and other business, separate meetings must be held with the creditors of each sort of business (Section 120 ICO; Schedule 8, paragraph 5 ICO). Where a court order is issued in respect of payments or contributions to be made to the company by delinquent directors etc., the order should specify to which business they should be applied (Section 120 ICO; Schedule 8, paragraph 6 ICO).

Gibraltar legislation distinguishes between general and long-term business in winding-up, with the same effects as in the UK, and where there is an excess of assets in one business it can be applied towards the other (Section 120 ICO; Schedule 8, paragraph 4 ICO). Long-term business essentially consists of life assurance and annuity policies and permanent health insurance. General business comprises accident, contingency and liability insurance.

Reduction of contracts

As an alternative to the making of a winding-up order in relation to an insurance company which has been proved unable to pay its debt, the court can reduce the amount of the contracts of the company on such terms and subject to such conditions as the court thinks fit. This alternative is provided for by virtue of Schedule 8, paragraph 3 ICO pursuant to Section 120 ICO. However, the writer is not aware of any circumstance where this power has been exercised, but it is a useful alternative to liquidation and keeping the insurance company solvent.

Voluntary winding-up

Under Section 204(1) CO a company may be wound up voluntarily if (a) when the period (if any) fixed for the duration of the company by the articles expires, or the event (if any) occurs, on the occurrence of which the articles provide the company is to be dissolved, and the company in general meeting had passed a resolution requiring the company to be wound up voluntarily; or (b) the company resolves by special resolution that the company be wound up voluntarily; or (c) the company resolves by extraordinary resolution to the effect that it cannot by reason of its

© 2004 Chase Cambria Publishing

liabilities continue its business, and that it is advisable to wind up. In the insurance sector voluntary liquidation is less than likely, and, as stated above in relation to insurance companies carrying on long-term business, voluntary winding-up is not possible.

Security interests

A financial institution providing capital for Gibraltar insurance companies would do so by way of loan to its shareholder(s). A direct loan to the insurance company would worsen, rather than improve, its capital position, as the regulators would, under the solvency requirements, treat a debt as a liability of that company and not as an asset. By structuring the finance as a loan to the shareholder(s), this allows the shareholder(s) to subscribe for additional share capital, with that capital sitting in the insurance company as equity (not debt) and therefore treated as an asset for regulatory purposes. In exchange for the loan finance, the shareholder(s) grants security over its shares in favour of the financial institution (by way of pledge and charge).

Following the enforcement of the security granted and the subsequent sale of any of the shares by the financial institution to a third party, such third party will be purchasing the shares pursuant to the power of sale. Accordingly, the purchaser will become the new controller of the insurance company. Any change of control is clearly a matter regulated by the ICO and statutory consent requirements would then apply.

Such security does not create a security interest over the assets of the company itself (shares in a company being a distinct item of property), so the question arises, can an insurance company give security over its own assets?

The conduct of insurance business by a licensed insurer is constrained primarily by Section 21 of the ICO. Section 21 provides:

> "No insurer licensed under this Ordinance shall undertake any activities in Gibraltar or elsewhere other than that of insurance, *except for the purposes of and in connection with the insurance business* which it is licensed to carry on."

Subject to this statutory restriction ("... for the purposes of and in connection with the insurance business ..."), the guiding principle applied by the regulators is that all insurance funds should be available for policyholders, the intended beneficiary of regulatory regime. However, there is no statutory prohibition on an insurance company granting security over its assets and, in principle, an insurance company may grant security, subject to rules on capital solvency and obtaining the consent of the regulators. This opens up the possibility for a financial institution to provide regulatory capital to allow an insurance company to underwrite business, taking limited subordinated security from the insurance company, subordinated to the interests of policyholders. There is as yet no final regulator's position on this point.

Admittedly, these security arrangements are of limited value. On insolvency the financial institution's position is really no better than that of a shareholder of an insurance company in run-off, and any additional but subordinated security simply puts a financial institution above general unsecured trade creditors on insolvency and does not considerably improve (if at all) the position of the secured creditor.

Effect of winding-up

The general rule of pari passu distribution of assets on insolvency is discussed below. The ability of the liquidator to preserve assets is prescribed by statutory provisions, principally as follows:

> In a winding-up by the Court any disposition of property by the company or any transfer of shares in the company made after presentation of the petition is void unless the Court otherwise orders (Section 161 CO).
>
> When a company is being wound-up any attachment, sequestration, distress or execution against the company's property after presentation of the petition is completely void (Section 162).

This is based on English statutory provisions, but is without prejudice to the enforcement by a secured creditor of his security after commencement of winding-up: the principle in *Lloyd v. David Lloyd & Co* [1876] 6 Ch D 339 would apply similarly under Gibraltar law. In relation to security over the shares themselves, the most likely situation, where these are fully paid, is that there is no real reason why a court should not give leave for transfers to be made on insolvency and presentation of a winding-up petition. It is obviously in the interest of the financial institution to keep a close eye on the insurance companies, calling for early enforcement of their security in an insolvency situation.

Nor does Gibraltar law apply any *special* insolvency procedures that would prevent secured creditors enforcing their security in a liquidation of a company (e.g. administration).

Priority of claims: unsecured creditors

Subject to certain modifications mentioned below, the winding-up of insurance companies in Gibraltar is governed by the same rules as those applicable to other companies.

All proceedings for the winding-up of a company whether voluntary or otherwise are subject to Section 239 (all debts must be proved) and 241 of the

© 2004 Chase Cambria Publishing

Companies Ordinance (i.e., all debts rank equally after debts to government, etc. – Sec 241 (1)–(2) See below). Additionally, in the event of a compulsory liquidation the Court would appoint the liquidator under Section 170 of the Companies Ordinance. The liquidator would have wide powers granted to him by Section 171–177 of the Companies Ordinance.

Sec 177 (1) CO provides the liquidator with the power to:

(a) bring or defend any action or other legal proceedings in the name and on behalf of the company;
(b) to carry on the business of the company, so far as be necessary for the beneficial winding-up thereof;
(c) to appoint a solicitor to assist him in the performance of his duties;
(d) to pay any classes of creditors in full;
(e) to make any compromise or arrangement with creditors or persons claiming to be creditors, or having or alleging themselves to have any claim, present or future, certain or contingent, ascertained or sounding only in damages against the company, or whereby the company may be rendered liable;
(f) to compromise all calls and liabilities to calls, debts and liabilities capable of resulting in debts, and all claims, present or future, certain or contingent, ascertained or sounding only in damages, subsisting or supposed to subsist between the company and a contributory, or alleged contributory, or other debtor or person apprehending liability to the company, and all questions in any way relating to or affecting the assets or the winding-up of the company, on such terms as may be agreed, and take any security for the discharge of any such call, debt, liability or claim, and give a complete discharge in respect thereof.

If the winding-up is voluntary the company may under Section 211 appoint a liquidator in a general meeting.

Section 226 of the Companies Ordinance applies to every winding-up; it states that "subject to the provisions of this Ordinance as to preferential payments, the property of a company shall, on its winding-up, be applied in satisfaction of its liabilities pari pasu, and, subject to such application, shall, unless the articles otherwise provide, be distributed among the members according to their rights and interests."

Under Section 241(3) all debts rank equally in priority after the debts in Section 241(1) and (2) have been satisfied. Section 241 gives priority to:

(a) all local rates due and payable within 12 months next before that date;
(b) all taxes due under Section 55(2) of the Income Tax Ordinance;
(c) all wages or salary (whether or not earned wholly or in part by way of commission) of any clerk or servant in respect of services rendered to the company during twelve months next before the relevant date not exceeding £1000;
(d) all wages of any workman or labourer not exceeding £1000 whether payable for time or for piece of work, in respect of services rendered to the company during twelve months next before the relevant date. Provided that, where any labourer in husbandry has entered into a contract for the payment of a portion of his wages in a lump sum at the end of the year of hiring, he shall have priority in respect of the whole of such sum, or part thereof, as the court may decide to be due under the contract, proportionate to the time of service up to the relevant date;
(e) all amounts, not exceeding in any individual case £500, payable by the company in respect of compensation under the Contract and Tort Ordinance, the liability wherefor accrued before the relevant date;
(f) all amounts payable by the company in respect of contributions as the employer of any person under the Social Security (Employment Injuries Insurance) Ordinance and under the Social (Insurance) Ordinance.

The foregoing debts rank equally among themselves. The effect of the above is that unsecured senior (i.e., unsubordinated) creditors (including secured creditors proving as ordinary creditors for the balance of their claim) of a company rank equally with each other but behind the following (in order of priority): (i) costs and expenses of the winding-up, (ii) preferential creditors, and (iv) creditors holding a floating charge (to the extent of the charge). In the case of an insolvent insurance company the result is that, generally speaking, the claims of its policyholders will rank equally with those of general unsecured and unsubordinated creditors.

Gibraltar company law also applies the same principles as apply to bankruptcy proceedings in relation to the winding-up of companies. Accordingly, by virtue of Section 31 of the Bankruptcy Ordinance, where there have been mutual credits, mutual debts or other mutual dealings, between a debtor against whom a receiving order is made under the Bankruptcy Ordinance and any other person proving or claiming to prove a debt under the receiving order, an account will be taken of what is due from one party to the other in respect of such mutual dealings, and the sum due from the one party shall be set off against any sum due from the other party, and the balance of account, and no more, shall be claimed or paid on either side respectively. As in the UK the rules of set-off and counter-claim in this context are mandatory and cannot be avoided by contractual agreement between the parties. These provisions will be particularly relevant in respect of derivative contracts entered into by insurance companies that rely on set-off and netting.

© 2004 Chase Cambria Publishing

Modification for insurance companies under ICO

Some statutory modification has been made to the pari passu rule, as they apply to insurance companies regulated under the ICO. As regards the priority of claims, the modification apply only to companies carrying on long-term insurance business. It does not directly affect the priority of claims applicable under the general rules mentioned above (in particular, no special priority is given to insurance policy holders over other unsecured creditors). However, the ICO requires that such a company must account separately for its long-term business assets and liabilities from other assets and liabilities of its business. Their effect is that, on a liquidation of the insurance company:

(1) assets representing the long-term fund are available only for meeting the liabilities of the company attributable to that business (this includes not only policyholders' but also other creditors' claims attributable to the long-term business); and

(2) any other assets of the company are available only for meeting the liabilities of the company attributable to the company's other business.

Where the value of the assets of the insurance company attributable to the long-term business exceeds the amount of the liabilities attributable to that business, the amount of the assets representing the excess may be applied to meet the liabilities attributable to the other business, and vice versa (Schedule 8, paragraph 4 ICO). The responsibility for determining which assets and liabilities are attributable to the long-term business lies primarily with the liquidator.

Further modification to the above is expected with the implementation of Directive 2001/17/EC on the reorganisation and winding-up of insurance undertakings came into effect (April 20, 2001) – see below.

Registration of security

Any security on a company's property requiring to be registered is void against any liquidator or creditor for failure to register. Although the creditor will still be able to sue the company for the debt, there is no security and no preferential ranking is given to the debt.

Section 77 (1) of the Companies Ordinance provides that every charge created after the commencement of the Ordinance by a company registered in Gibraltar and being a charge to which the section applies shall, so far as any security on the company's property or undertaking is conferred thereby, be void against the liquidator and any creditor of the company, unless the prescribed particulars of the charge, together with the instrument (if any) by which the charge is created or evidenced, are delivered to or received by the Registrar for registration in the manner required by this Ordinance within twenty-one days after the date of its creation, but without prejudice to any contract or obligation for repayment of the money thereby secured, and when a charge becomes void under this section the money secured thereby shall immediately become payable.

Section 77 applies to:

(a) a charge for the purpose of securing any issue of debentures;
(b) a charge on uncalled share capital of the company;
(c) a charge created or evidenced by an instrument which, if executed by an individual, would require registration as a bill of sale;
(d) a charge on land, wherever situate, or any interest therein;
(e) a charge on book debts of the company;
(f) a floating charge on the undertaking or property of the company;
(g) a charge on calls made but not paid;
(h) a charge on a ship or any share in a ship;
(i) a charge on goodwill, on a patent or a licence under a patent, on a trademark or on a copyright or a licence under a copyright.

The practice in relation to the granting of security by a Gibraltar company over its shareholding in another Gibraltar company is to register the charge pursuant to Section 77 of the CO. This is relevant where the shares in an insurance company have been charged to a financial institution by its Gibraltar parent company. In most instances the security will fall to be registered as a charge over book debts.

Schemes of Arrangement

As stated above, there is no concept in Gibraltar law of administration or rehabilitation proceedings whereby a debtor can effectively freeze the rights of creditors, including in certain cases creditors rights to enforce security interests.

These sort of proceedings are therefore intended to enable the ultimate survival of the company subject to the order as a going concern (in whole or in part) or to permit a more advantageous realisation of the company's assets than would be effected on an immediate winding-up.

An insurance company with inadequate assets to settle its liabilities would most likely cease underwriting new business and will settle its liabilities often at a reduced rate whilst still technically solvent. An insurer in "run-off" may not go into liquidation for a number of years but will nonetheless have ceased accepting new business and therefore premium income.

The provisions in Section 145 for compromises or arrangements ("Arrangements") would be most relevant here since they would allow an insurance company to conclude a run-off. These are Arrange-

© 2004 Chase Cambria Publishing

ments agreed by creditors and, in some cases, shareholders of a company. The courts will not sanction the Arrangements unless reasonable efforts were made to notify those creditors whose rights would be affected by the scheme of the meeting to approve the Arrangements. Approval at the creditors' meeting of the terms of the Arrangements does not require unanimity of the affected creditors, whether or not present at the meeting. Such Arrangements could affect both set-off rights of creditors and the value of claims the creditors may have against the company. Section 145 is similar to Section 425 of the Companies Act 1985 (England).

However, Section 145 as a stand-alone insolvency procedure does not provide for a stay on claims by creditors against the company whilst the scheme is being prepared and approved. Therefore it remains open to any creditor to present a winding-up petition or commence or continue other proceedings against the company prior to the sanction of the court to the scheme being obtained. Furthermore, there is no mechanism under the scheme procedure whereby an insolvency practitioner can be appointed to manage the company's affairs pending the approval of the scheme.

The court's power (discretionary) to stay any pending action or proceeding on presentation of a winding-up petition is allowed under Section 160 on the application of the company, any creditor or contributory.

Gibraltar is likely to follow UK practice with regards to the implementation of "scheme" procedure in an insurance insolvency context. There is as yet no established local practice, so the UK experience should be very helpful to insolvency practitioners in the future.

Provisional liquidator

The effect of appointing a provisional liquidator in Gibraltar (Section 165) is the same as under the UK: the appointment of a provisional liquidator results in a mandatory stay of proceedings being brought against the company (except by leave of the court and subject to such terms as the court may impose). The appointment of a provisional liquidator by the court may be made at any time after the presentation of a winding-up petition (Section 171 (2)) and before the making of a winding-up order (Section 171 (2)). The court may limit and restrict his powers by order appointing him (Section 171 (3)).

In relation to insolvent insurance companies, Gibraltar is also likely to follow UK practice in this area, and, in particular, English case-law in respect of the equivalent English law provisions will be highly persuasive in Gibraltar. To the present writer's knowledge, these provisions have as yet not been used in a Gibraltar insurance insolvency situation in the same way as they have been used, combined with schemes of arrangements, in the UK. Local insolvency practitioners and regulators will no doubt view the application of this combined procedure in the UK with interest.

Receivership

With respect to a receivership procedure pursuant to the powers given in a charge, this is not an insolvency proceeding in the strict sense, even though in practice it may operate as such. The receiver in the narrow sense has limited powers granted under a security document in relation to particular assets. It has only those management powers that are contained in the charge in relation to the general assets of the company and no statutory responsibility to consider the interests of creditors generally. For the reasons given above, Gibraltar insurance companies are unlikely to end up in a receivership appointed pursuant to a debenture deed.

Avoidance of transactions

On liquidation, any transaction entered into by a Gibraltar company (including an insurance company) may be held to be wholly or partly invalid as a result of any of the following sections (if the circumstances described in any of these sections is applicable):

First, the liquidator has the power of disclaimer provided for in Section 244 of the CO. It is a general principle of disclaimer under English common law that a liquidator may not disclaim only part of a contract. Disclaimer is all or nothing: consider *Re Bastable* [1901] 2 KB 518; *Re The Nottingham General Cemetery Co* [1955] Ch 683. The policy is that the liquidator should not take the benefit of a contract without the burden. A Gibraltar Court is again likely to follow English case-law where the similar statutory provisions in England have fallen to be interpreted by the English Courts.

Second, any action taken by the company to defraud creditors in favour of a person during the relevant suspect period before the commencement of its winding-up, in the event of the company's insolvent liquidation may be set aside as a fraudulent preference under Section 242 of the CO. Again, this is based on the equivalent statutory provision in the Companies Act 1929 (England) and it is most unlikely that a transaction entered into by a Gibraltar insurance company at arm's-length will be capable of being set aside as a fraudulent preference.

Gibraltar legislation does not include the statutory concepts of wrongful trading or transactions at an undervalue found in the UK Insolvency Act 1986.

© 2004 Chase Cambria Publishing

Foreign insolvency proceedings: Auxiliary jurisdiction

Section 98 (1) of the Bankruptcy Ordinance provides that the Supreme Court shall act in aid of and auxiliary in all matters of bankruptcy, to, inter alia, every court in the UK having jurisdiction in bankruptcy or insolvency.

The Supreme Court of Gibraltar shall also act in aid of courts in the European Community (other than the UK) in respect of insolvency proceedings falling under Council Regulation 1346/2000 on insolvency proceedings (Section 98(2)). This is not relevant to insurance companies.

There is no equivalent of Section 426 Insolvency Act (England) in the case of insolvent companies, but it is likely that a letter of request from an English court will be treated sympathetically with a view to giving assistance under the English case-law principles which operate outside Section 426.

The future of the Protected Cell Company

Gibraltar's Protected Cell Company ("PCC") Ordinance was implemented last year and the legislation is based on the Guernsey model. Gibraltar is the only EU jurisdiction that has PCC legislation available to insurance companies. The legislation is intended to segregate the assets and liabilities of an insurance company (or collective investment scheme) as between cells so that, for example, the assets in cell 1 are only used to pay the liabilities/creditors of that cell. The company is therefore subject to a special insolvency regime, which regime permits a matching of particular assets to particular liabilities, so as to protect separate economic interests (known as cells). This new type of corporate entity brings with it new challenges to insolvency law and is also likely to impact in a cross border insolvency situation. It is a patent and serious derogation to the pari passu principle of insolvency, since until now, the only significant modification was in relation to long-term insurance business intended to protect policyholders.

Prior to Gibraltar introducing PCC legislation, there had been some doubts expressed as to the integrity of such legislation if challenged outside the jurisdiction Gabriel Moss QC's was instructed by the writer of this article in 1999 on behalf of the Government of Gibraltar to advise on this matter. These doubts, however, had not stopped protected cell companies being formed in other offshore centers (principally among these Cayman Islands, Guernsey and Bermuda). Certainly, some of these structures are perceived to be less risky than others, and those who manage protected cell companies are effectively in a position to control many of these risks. They are therefore issues all jurisdictions implementing such legislation have had to consider. Recently, however, doubts as to the compatibility of PCC legislation in an EU insurance insolvency context have surfaced in relation to Directive 2001/17/EC on the reorganisation and winding-up of insurance undertakings which came into effect (April 20, 2001). Again, the writer instructed Gabriel Moss QC on behalf of the Government of Gibraltar to advise on the possible impact the Directive could have on domestic legislation and the Government is now seeking to amend the legislation accordingly.

Greater protection for policyholders

Article 10 of the Insurance Insolvency Directive requires a fundamental modification to the pari passu principle in an insurance insolvency (where basically, subject to an alternative approach, insurance claims must be given precedence over all other claims). The exact wording of Article 10(b) is "insurance claims shall, with respect to the whole of the insurance undertaking's assets, take precedence over any other claim on the insurance undertaking with the only possible exception of ... [claims by employees, public bodies in relation to taxes, social security claims and claims on assets subject to rights in rem] ..."

The Directive which is aimed at providing greater protection for policyholders could potentially impact on Gibraltar protected cell companies in that, on a literal interpretation of Article 10, the whole assets of the corporate entity (without segregation as between cells) must be made available to meet the claims of insurance creditors. If applied in this way, then, on insolvency, all assets of an insurance company would be required to be distributed so that insurance claims (or under the alternative approach, the claims mentioned in the Directive) take precedence over other creditor claims, thus setting aside the statutory cell structure in a PCC. The Directive requires implementation by local laws before April 20, 2003.

The issue which promoters of protected cell companies, regulators and their legal advisers will have to address carefully is how the statutory separation of cell assets and liabilities for this type of companies is going to be reconciled with the Insurance Insolvency Directive approach to insurance insolvency. The other potential problem in the medium to long term is whether protected cell company legislation in Gibraltar will survive other possible EU initiatives in an insolvency context.

Compensation scheme

There is currently no insurance compensation scheme in Gibraltar.

The question arises as to whether policyholders resident in the United Kingdom who effect policies with insurance companies based in Gibraltar are covered by the Financial Services Compensation Scheme (FSCS) established under the (UK) Financial

© 2004 Chase Cambria Publishing

Services & Markets Act 2000.

The view taken is that the UK compensation arrangements do apply. The UK Regulations refer to products from insurers in the UK and "other EU member States". Gibraltar is not, of course, a separate Member State. It is part of the EU by virtue of UK membership, although it is not part of the UK itself. In principle, there is no reason why the UK compensation scheme should not be interpreted as applying to products from Gibraltar that are sold to UK resident policyholders under UK approved EU "passport" arrangements.

Outlook

The Gibraltar insurance sector is looking robust and its outlook is very positive. The ability of Gibraltar-licensed insurance companies to write business across the EU is paying enormous dividends, although at the moment the sector seems increasingly focused towards the UK market. With a regulatory regime intended to match that of the UK, and with its close historical and current links with the British mainland, Gibraltar offers an attractive alternative for companies looking to set up an insurance operation to write EU business. On the insolvency front, Gibraltar will be bound by EU changes in the future, unless expressly excluded from their application. Otherwise, Gibraltar is in principle likely to follow the lead set by UK reforms, but in practice, in respect of general corporate insolvency, it is still essentially applying the UK Companies Act 1929, albeit with the advantage of the development of English case-law, in so far as it is compatible with that legislative structure. With a growing number of newly capitalised insurance companies being set up in Gibraltar, insolvency is, of course, the last thing in anyone's mind at present.

© 2004 Chase Cambria Publishing