



HM TREASURY

Strengthening the administration regime for insurers:

a consultation

March 2010



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Executive summary

The UK insurance industry is a key part of the UK financial services sector and is the second largest insurance industry worldwide. It accounts for 11 per cent of premiums globally and, in 2008, it controlled 13.4 per cent of the UK stock market.¹

Currently, there are 972 companies authorised by the Financial Services Authority (FSA) to carry out insurance business in the UK. Of these:

- 735 carry out general business only (which includes, for example, motor, household and commercial insurance);
- 193 carry out long-term business only (such as life insurance and pensions); and
- 44 carry out both general and long-term business.

The incidences of insurers being put into administration or being wound-up in the UK have been low, with no incidences occurring during the recent period of financial instability. The last case of a life insurance company going into liquidation was Oaklife Assurance Company, in September 1993. As a result the procedures and processes surrounding insurers entering into administration, which have evolved over time, have not been developed significantly either in practice or in law.

However, in the light of reviewing other insolvency regimes across the financial services industry, and reflecting on the lessons learnt during the financial crisis, the Government considers that some aspects of the administration regime for insurers could be strengthened.

This consultation seeks views on Government proposals to improve the protection and payment of benefits for holders of insurance contracts with an insurer facing financial difficulties, in particular addressing gaps in protection that remain in the administration regime for insurers in comparison to the liquidation regime. The Government proposals include:

- applying the existing rules for valuing contracts of insurance in liquidation to administration; and
- revising the objectives of an administrator of an insurance company, by:
 - changing the law to require administrators to provide assistance to the FSCS to enable it to administer the compensation scheme and secure continuity of contracts of insurance; and
 - applying existing powers relating to continuity of contracts of long-term insurance on the liquidation of an insurer to administration.

The Government invites responses to the consultation questions posed. Respondents are free to frame their response and input as they see appropriate. Annex B summarises the consultation questions. An Impact Assessment can be found in Annex C, which should be read in conjunction with the consultation document and Annex D sets out the draft Financial Services and Markets Act 2000 (Administration Orders Relating to Insurers) Order 2010.

The consultation period starts with the publication of this document and will run for 12 weeks. Please ensure that responses reach HM Treasury by **25 June 2010**.

¹ Source: Association of British Insurers Key Facts September 2009

1

Introduction

1.1 The UK insurance industry is a key part of the UK financial services sector and is the second largest insurance industry worldwide. It accounts for 11 per cent of premiums globally and, in 2008, it controlled 13.4 per cent of the UK stock market.¹

1.2 Insurance companies currently offer two main types of contracts of retail insurance:

- long-term, which covers life insurance products, including personal pensions and pure protection contracts (such as term, income protection and critical illness insurance); and
- general, which includes both compulsory insurance (such as motor third party insurance and employers' liability insurance) and non-compulsory insurance such as household and private medical insurance.

1.3 Currently, there are 972 companies authorised by the Financial Services Authority (FSA) to carry out insurance business in the UK. Of these:

- 735 carry out general business only (which includes, for example, motor, household and commercial insurance);
- 193 carry out long-term business only (such as life insurance and pensions); and
- 44 carry out both general and long-term business.

1.4 In 2008, the Association of British Insurers (ABI) reported £168 billion was received in premium income for life and savings business. UK insurers invested £1.5 trillion of assets on behalf of their policyholders and received £33 billion in investment income.

1.5 In the same year, UK insurance companies received £47 billion in premium income (net of reinsurance) for general insurance, and paid out £30 billion to policyholders.

The aim of this consultation

1.6 The recent period of disruption in the global financial markets has had a widespread impact across the world. Like many industries, the UK insurance sector has been affected; however, both the insurance industry and the UK's prudential regulatory regime for insurers have stood up well to testing economic conditions.

1.7 In response to the financial crisis, the Government took steps to strengthen the resolution arrangements for banks in distress. These included introducing, under Parts 2 and 3 of the Banking Act 2009, two new insolvency procedures based on existing insolvency procedures (liquidation and administration), with modifications where required, under the Insolvency Act 1986:

- the bank insolvency procedure (BIP) in Part 2 of the Banking Act 2009, which provides for the orderly winding up of a failed bank and for faster Financial Services

¹ Source: Association of British Insurers Key Facts September 2009

Compensation Scheme (FSCS) payments to eligible claimants or a transfer of such accounts to another financial institution; and

- the bank administration procedure (BAP) in Part 3 of the Banking Act 2009, which is a procedure for the special administration of an insolvent 'residual bank' created by a partial transfer of a bank's property.

1.8 In the light of reviewing other insolvency regimes across the financial services industry, and reflecting on the lessons learnt during the financial crisis, the Government considers that some areas of the administration regime for insurers, which has evolved over time, could be strengthened.

1.9 In this consultation, the Government seeks views on whether to refine the administration regime for insurers to improve the continuity of payments and protection for policyholders should an insurer go into administration, in particular, by:

- adopting certain aspects of the liquidation regime for contracts of long-term insurance incorporated in section 376 of Financial Services and Markets Act 2000 (FSMA), and under the Insolvency Act 1986 and the Insurers (Winding Up) Rules 2001; and
- adding specific duties to the objectives of the administrator of an insurer in addition to those currently required under Schedule B1 to the Insolvency Act 1986.

The evolution of the administration regime for insurers

The Insolvency Act 1986

1.10 Schedule B1 to the Insolvency Act 1986 provides for an administrator to have one of three objectives, which includes rescuing a company as a going concern or achieving a better result for creditors than an immediate winding up. While it is possible to arrange a transfer of assets or parts of the business in liquidation, it is more likely to involve the realising of the company's assets, distributing the proceeds to creditors and then dissolving the company as a legal entity.

1.11 The Insolvency Act 1986, however, did not initially permit an insurance company to be put into administration. When it was adopted, it was considered that:

- given the different nature of insurance business, administration would not be an appropriate procedure for insurers, in particular for those businesses that provide insurance policies with long-term contracts;² and
- as there were a number of existing alternative provisions for insurers in, for example, the Insurance Companies Act 1982, and the Insurance Companies (Winding-Up) Rules 1985, specific provisions for administration were not necessary.

1.12 In the absence of an administration option under the Insolvency Act 1986, insurers in financial difficulties in practice chose to adopt the practice of petitioning the courts for the appointment of a provisional liquidator. This ensured that the interests of policyholders with long-term contracts were immediately protected, as the liquidator could continue to receive premiums and pay claims with a view to transfer this aspect of the business to a person who can

² An administrator is specifically required to carry out his or her functions in the interests of the company's creditors as a whole. Where there are insufficient resources available to pay unsecured creditors (such as insurance policyholders) in full, an administrator can only act in a way that does not unnecessarily harm the interests of the creditors of the company as a whole. This approach may have a negative impact on insurance policyholders, particularly those with long-term contracts (such as life and annuity policies), who rely upon the cash-flows from their matured policies as their main source of income.

lawfully carry out those contracts (as permitted under section 56 of the Insurance Companies Act 1982).

The Financial Services and Markets Act 2000

1.13 The Financial Services and Markets Act 2000 (FSMA), which received Royal Assent on 14 June 2000, established a new, single regime for the statutory regulation of financial services, including insurers in the UK, and established the FSA as the single statutory regulator for financial services.

1.14 Section 360 of FSMA gave HM Treasury (the Treasury) the power to modify Part II (Administration Orders) of the Insolvency Act 1986 to allow insurers to be placed in administration. In 2002, the Government made use of this power and through the Financial Services and Markets Act 2000 (Administration Orders Relating to Insurers) Order 2002 some modifications to extend the administration regime to insurers were made. This new administration regime for insurers was aligned with certain aspects of the liquidation regime for insurers.

The Financial Services Compensation Scheme for insurers

1.15 The Financial Services Compensation Scheme (FSCS), which was established under FSMA, acts as the UK's compensation fund of last resort for customers of financial services firms (which include credit institutions and insurers). This means that the FSCS protects consumers, if an authorised financial services firm were unable, or were likely to be unable, to pay claims against it.

1.16 For insurers, the FSCS is the successor to the Policyholders Protection Board. One of the FSCS triggers for the insurance sector includes the appointment of an administrator. Once triggered, the FSCS under the Compensation (COMP) Sourcebook of the FSA Handbook (COMP 3.3.1-3.3.2 - made under section 216 of FSMA) is required to make arrangements to secure continuity of insurance for eligible claimants who have protected life insurance contracts and has the power to make such arrangements for protected contracts of general insurance.

1.17 The maximum FSCS compensation for policyholders of an insurer in administration is 90 per cent of the claim for protected life insurance contracts (if continuity cannot be secured) and for protected general insurance contracts. Compulsory insurance is protected in full. For the process to work efficiently, it is important that the administrator provides assistance to the FSCS in its role as scheme manager, to ensure that the FSCS has access to the administrative resources of the insurer.

1.18 The FSCS must make arrangements to secure continuity for insurance contracts if:

- it is reasonably practicable to do so; and
- the FSCS is satisfied that the arrangements would be beneficial to the generality of the eligible claimants covered by the arrangements.

1.19 The FSCS must ensure that the claimant will receive at least 90 per cent of the benefits under the policyholder's previous contract (if the FSCS secures less than 100 per cent of the benefits under a contract, the FSCS must ensure that any future premiums are reduced by an equivalent amount).

1.20 For general insurance contracts and life insurance contracts where the FSCS is not securing continuity, the FSCS may take measures to safeguard policyholders of an insurance company that is in financial difficulty. FSCS must secure that life insurance benefits falling due after the default are paid whilst it explores the continuity options.

Insurers in insolvency

1.21 The incidences of insurers being put into administration or being wound-up in the UK have been low, with no incidences occurring during the recent period of financial instability. This has resulted in the procedures and processes surrounding insurers entering into administration not being highly developed either in practice or in law.

1.22 The last case of a life insurance company going into liquidation was Oaklife Assurance Company, in September 1993. From 1989 to February 2010, in the London insurers market, insolvencies totalled 54, the majority of which arose from the reinsurance sector or insurers affected by the failure of reinsurers.³ Table 1.A shows how these insolvencies were resolved.

Table 1.A: Table to show the number of insurers in the UK subject to insolvency or restructuring proceedings (1989 - February 2010)

Insolvency procedure	Number
Administration	2
Provisional Liquidation	3
Run-off Scheme of Arrangement	11
Valuation Scheme of Arrangement	32
Liquidation	6
Total	54

Source: Guide to London Market Insolvencies since 1989, PriceWaterhouseCoopers (1 February 2010)

Possible concerns about insurers entering administration

1.23 Despite the low number of insolvencies in the insurance sector, distinct gaps remain in the administration regime for insurers in comparison to the liquidation regime. This could result in policyholders, in particular those with long-term contracts of insurance, not receiving equivalent protection under insolvency law when an insurer is in administration as would apply when the insurer goes into liquidation. In particular:

- there are no rules for the valuation of general or long-term insurance contracts in administration, resulting in a lack of clarity on how to deal with these contracts once an insurer defaults; and
- although an administrator currently has the power to:
 - provide assistance to enable the FSCS to administer the compensation scheme and secure continuity of contracts of insurance; and
 - continue the business of the insurer and make payments under any policies;the administrator is not required to do so.

Valuation of insurance contracts

1.24 Although the Financial Services and Markets Act 2000 (Administration Orders Relating to Insurers) Order 2002 modified the administration regime for insurers to some degree, it did not provide a comprehensive regime for insurers, as at that time it was considered that the existing alternative provisions for insurers were sufficient. However, now further revisions are considered necessary as, for example, the rules for valuation of both general and long-term contracts in the

³ Guide to London Market Insolvencies since 1989, PriceWaterhouseCoopers 1 August 2008

event of a winding-up under the Insurers (Winding Up) Rules 2001 do not apply when an insurer goes into administration.

Providing assistance to the FSCS

1.25 When an insurer faces financial difficulties, the FSCS plays an important role in providing compensation and continuity of payments, as well as protection, for policyholders with general and/or long-term contracts of insurance. Given that some policyholders rely on the insurance benefit payments, any significant delay in receiving these payments could result in hardship.

1.26 For the FSCS process to work efficiently, it is considered that an administrator should be required to provide assistance to the FSCS to enable it to administer the scheme and to secure continuity of long-term insurance contracts, mobilising the administrative resources of the insurer.

Continuation of long-term contracts

1.27 Section 376 of FSMA ensures that, where possible, long-term insurance contracts will continue where an insurer goes into liquidation. Unless otherwise directed by a court, the liquidator is required to maintain existing contracts so that they may be transferred to another insurer as a going concern.

1.28 In contrast, when an insurer is in administration, although an administrator currently has the power to continue the business of the insurer (activities of which includes collection of premiums, managing investments and the payment of benefits under any policies), the administrator is not required to do so.

1.29 In the majority of cases, terms and pricing of insurance policies are set at inception of a contract. If the continuity of policies of long-term contracts is not preserved (i.e. if they terminate or lapse early due to, for example, the insurer becoming insolvent), the policyholder could be disadvantaged, suffer loss of benefits and face additional costs in replacing the benefits. When an insurer becomes insolvent, the personal circumstances of the policyholder at that time might have changed to such a degree from when he or she entered into the contract, that they are unable to obtain equivalent replacement policies, in relation to terms and price, from another insurer.

Strengthening the administration regime for insurers

1.30 In the light of reviewing other insolvency regimes across the financial services industry and lessons learnt across the financial sector the Government has identified a number of areas where the administration regime for insurers could be strengthened. This consultation seeks views on proposals to amend the existing administration regime by:

- applying the existing rules for valuing contracts of insurance in liquidation to administration; and
- revising the objectives of an administrator of an insurance company, by:
 - changing the law to require administrators to provide assistance to the FSCS to enable it to administer the compensation scheme and secure continuity of contracts of insurance; and
 - applying existing powers relating to continuity of contracts of long-term insurance on the liquidation of an insurer to administration.

Modifications to the tax rules for insurers in administration

1.31 More broadly, the Government has undertaken a review of relevant tax law and provided a power to revise the tax rules to ensure that the tax treatment of the insurer and holders of insurance contracts with the failing insurer remain the same regardless of FSCS intervention.

1.32 Tax rules apply in connection with insurance contracts to ensure that tax charges/reliefs apply as intended, as well as to prevent tax avoidance and to protect the policyholder. Under the current tax regime, if the FSCS were to intervene to assist an insurer that faced financial difficulties, unintended tax impacts may arise. More information is provided in Annex A.

2

Proposals to amend the administration regime for insurance companies

2.1 This Chapter outlines the proposals to improve the continuity of benefit payments and protection under the insurance policies for policyholders should an insurer go into administration. The proposals are to:

- apply the existing rules for valuing contracts of insurance in liquidation to administration; and
- revise the objectives of an administrator of an insurance company, by:
 - changing the law to require administrators to provide assistance to the FSCS to enable it to administer the compensation scheme and secure continuity of contracts of insurance; and
 - applying existing powers relating to continuity of contracts of long-term insurance on the liquidation of an insurer to administration.

2.2 These proposals would affect administrators of insurance companies, as well as creditors of such companies. The Government considers that any increases in the costs to an administrator of an insurer brought about by these proposals is likely to be modest in the context to the size and scale of the insurance sector. The Government further does not consider that there will be a significant reduction in the rate of return for creditors as a whole. More details are provided in the accompanying Impact Assessment (Annex C).

Valuing contracts of insurance

2.3 The Insurance (Winding Up) Rules 2001 provide rules for valuing insurance contracts in a winding-up (i.e. during the liquidation of an insurer). These rules set out the separate methodologies for valuing general insurance contracts and long-term contracts of insurance.

2.4 Currently, the administration regime for insurers does not contain rules for valuing insurance contracts. While it is likely that an administrator would use the methodologies for valuation set out in the 2001 Rules, the Government considers that by applying the existing valuation rules for liquidation to the administration regime of insurers, administrators would have greater certainty as to which rules to apply in valuing contracts of insurance. Article 3 of the draft Order (Annex D) applies the valuation rules set out in the Insurers (Winding Up) Rules 2001 to the administration of insurers.

Consultation question:

- 1 Do you agree that the valuation rules set out in the Insurers (Winding Up) Rules 2001 should be applied to insurance companies in administration?

Revising the objectives of the administrator of an insolvent insurance company - providing assistance to the FSCS

2.5 The FSCS acts as the UK's compensation fund for customers of financial services firms (which include credit institutions and insurers) participating in the scheme. This means that the FSCS

will protect consumers if one of these participating firms is unable, or likely to be unable, to pay claims against it. The FSCS is funded by a levy on scheme participants.

2.6 Paragraph 3 of Schedule B1 to the Insolvency Act 1986 requires the administrator to perform his functions in the interests of the company's creditors as a whole, with the objective of:

- rescuing the company as a going concern, or;
- achieving a better result for the company's creditors as a whole than if the company had been wound up, or;
- realising property in order to make a distribution to one or more of the preferential creditors.

2.7 The Government proposes to place an additional duty on an administrator, to provide assistance to the FSCS to ensure it is able to fulfil its obligations which includes securing continuity and payment of long-term insurance contracts (see paragraph 1 of the Schedule to the draft Order at Annex D, which inserts a new sub-paragraph (1A) into paragraph 3 of Schedule B1 to the Insolvency Act 1986). The Bank Insolvency Procedure (BIP) in Part 2 of the Banking Act 2009 similarly provides a special objective to the bank liquidator to work with the FSCS to ensure a fast pay out to depositors if a bank were to become insolvent.

2.8 A duty to assist the FSCS in order to enable it to administer the compensation scheme will benefit holders of long-term or general insurance policies. The proposed duty will require the administrator of an insurer in financial difficulties to assist the FSCS in, for example:

- assessing claims;
- paying benefits falling due on long-term policies;
- maintaining existing cover; and
- facilitating a transfer to another insurer.

2.9 This is necessary because these functions require the knowledge, resources and records of the company. Providing access to management information and skilled resources to manage and operate processes within the insurer should, for example, allow for:

- more timely payments to policyholders of benefits falling due to be paid;
- timely compensation payments if the FSCS has not been able to secure continuity of cover; and
- continuity of premiums collection.

2.10 The continuity of long-term insurance by the FSCS is particularly important given that some policyholders may rely on the insurance payments, and any significant delays in these payments could result in hardship. For the FSCS to work efficiently, the Government considers that an administrator should be required to provide assistance to the FSCS to enable it to secure continuity of long-term insurance contracts, mobilising the administrative resources of the insurer.

2.11 The FSCS may similarly seek to secure continuity of general insurance. To facilitate these circumstances, it has been suggested that a duty could be placed on an administrator to assist the FSCS, as if the FSCS were to take this action, it will need assistance from the administrator to do so.

2.12 To ensure that the duty is effective, it is proposed that the requirement to provide assistance to the FSCS should be made an exception to the administrator's duty under

paragraph 3(2) of Schedule B1 to the Insolvency Act 1986 to act in the interests of the company's creditors as a whole.

Consultation questions:

- 2 Do you agree that the administrator should have a duty to provide assistance to the FSCS to enable it to administer the compensation scheme?
- 3 Do you consider that the administrator should have a duty to provide assistance to the FSCS to enable it to secure continuity of long-term insurance contracts?
- 4 Do you consider that the duty to assist the FSCS in securing continuity of insurance contracts should also apply in relation to general insurance contracts?

Continuity of insurance contracts of an insurer in administration

2.13 Section 376 of FSMA seeks to ensure continuity of contracts of long-term insurance and provides a framework for dealing with these types of contracts. More specifically, section 376 of FSMA:

- imposes a duty on the liquidator to carry out the insurer's contracts of long-term insurance with a view to a transfer of that part of the business to another insurer and gives the liquidator related powers;
- permits the liquidator to agree the variation of insurance contracts in force;
- permits the liquidator of an insurer that carries out contracts of long-term insurance to apply to the court for the appointment of a Special Manager if the interests of the creditors require it. The Special Manager is able to provide the liquidator with particular commercial or managerial expertise that the liquidator does not have; and
- gives the court the right to reduce the value of one or more contracts of long-term insurance when an insurer is being wound-up. Either the liquidator or the FSA (or the Special Manager) may apply to the court to appoint an independent actuary to investigate the insurer's long-term business and report back to them on whether the business should be continued and on any reduction in contracts that may be necessary.

Continuity of contracts of long-term insurance

2.14 In contrast to the winding-up regime, the appointed administrator of an insurer does not have a duty to carry on the contracts of long-term insurance with a view to transferring them to an alternative insurer. Although policyholders have a right to compensation where an insurer defaults, and will therefore be able to recover the majority of the amounts due through the FSCS (though this is limited to 90 per cent of the claim in relation to long-term insurance contracts), this may only be after some delay due to, for example, the time required to make a claim to the FSCS, and for that claim to be administered. As many policyholders rely upon payments under these policies as their main source of income, any significant delays in payment benefits could result in hardship for a number of vulnerable sectors of the population, including pensioners and the sick.

2.15 As the terms and premiums of long-term contracts of insurance are generally set at inception, if an insurer later becomes insolvent, the personal circumstances of the insured may have changed to such a degree that they are unable to find equivalent protection from other insurance providers.

2.16 To alleviate any potential distress caused to holders of long-term insurance contracts with an insurer that has entered into administration, the Government considers that there is a need to adopt in administration the same protection as afforded in liquidation for the holders of long-term insurance contracts. This would need to be alongside the administrator providing assistance to the FSCS to enable it to issue continued payments and to continue the collection of premiums.

2.17 The proposed duty will impose a requirement on the administrator to carry out the insurer's contracts of long-term insurance with a view to the transfer of part or all of the business to another insurer, and it will be made clear that this duty is an exception to the administrator's duty to act in the interests of the company's creditors as a whole.

Consultation question:

- 5 Do you agree that the administrator should be required to maintain contracts of long-term insurance?

2.18 Currently under the liquidation regime a liquidator is not permitted to enter into new contracts of insurance. The Government is of the view that it is preferable to align the protection afforded to policyholders in the event an insurer were to be placed in administration with that of being put in liquidation. Prior to administration, the regulatory supervision framework in place is most likely to have varied the insurer's permissions, thereby preventing it from continuing to write new business. It is, therefore, envisaged that this alignment would only relate to existing policyholders and arrangements in place with the insurer.

2.19 However, under certain arrangements (such as a group personal pension arrangement¹ or convertible term assurance products²), a power to enter into new contracts could be beneficial. Under these arrangements, its absence may impede the FSCS fulfilling its objective of maintaining the business of the company.

2.20 While an insurance firm is in administration, in order to continue the business of the insurer, the administrator would have to continue to make and act on decisions to invest the firm's capital in the interest of the creditors as a whole. Any additional liability introduced through new contracts would be minimal in comparison to the existing book of the insurer and therefore any burden on administrator to take on new business is likely to be low.

Consultation question:

- 6 Do you consider that an administrator should be permitted to enter into new contracts of long-term insurance where it relates to existing policyholders and arrangements in place?

Variation of contracts in administration

2.21 Under section 376 of FSMA, the liquidator of an insurer is permitted to agree the variation of insurance contracts in force. This flexibility allows the liquidator to adjust a contract whose original terms may be unreasonably burdensome for the company, while ensuring that the contract will continue to the benefit of the claimant.

¹ A group personal pension arrangement is a series of individual contracts between insurer and employee. Without the power to effect new contracts, an insurance company in administration would not be able to accept new employees into the GPP arrangement. This could result in an employer having to set up a new GPP with another insurer for all new employees, creating an additional cost to the employer. To mitigate against the additional costs associated with providing multiple GPPs, the employer may wish to move all employees to the new arrangement, reducing the potential re-saleability of the insurance company.

² A convertible term assurance product is where the insurer is required to renew or affect a new insurance policy for a specified amount of time regardless of changes to the policyholder condition such as health.

2.22 The Government proposes to give the same power to an administrator (see paragraph 3A(3) of Schedule B1 to the Insolvency Act 1986, as inserted by paragraph 2 of the Schedule to the draft Order (Annex D)).

Consultation question:

- 7 Do you agree that the power to agree variation of contracts in force should be given to the administrator?

The appointment of a Special Manager

2.23 As set out under section 376 of FSMA, liquidators of an insurer that undertakes contracts of long-term insurance may apply to the court for the appointment of a Special Manager, if the interests of the creditors require it. The Special Manager would be able to provide the liquidator with particular commercial or managerial expertise.

2.24 The Government considers that it is just as important for an administrator to have access to such expertise in relation to an insurance business, and paragraph 3A(4) and (5) of Schedule B1 to the Insolvency Act 1986 as inserted by paragraph 2 of the Schedule to the draft Order (Annex D) would give this option to the administrator.

Consultation question:

- 8 Do you agree that the administrator should have the same power to apply to the courts for the appointment of a Special Manager, as currently held by the liquidator?

Reducing the value of contracts of long-term insurance

2.25 The Government proposes to replicate in administration, the provision under section 376 of FSMA for insurers in liquidation, thereby giving the court the right to reduce the value of one or more contracts of long-term insurance when an insurer is in administration (paragraphs 3A(7) to (10) of Schedule B1 as inserted by paragraph 2 of the Schedule to the draft Order (Annex D)).

2.26 This new provision would enable either the administrator or the FSA (or the Special Manager) to apply to the court to appoint an independent actuary to investigate the insurer's long-term business and report back on whether the business should be continued and on any reduction in contracts that may be necessary. This measure has the potential to provide better outcomes for all parties in an administration.

Consultation question:

- 9 Do you agree that the courts should be given the power to reduce the value of contracts and to appoint an independent actuary, in the event of an insurer going into administration?

Other questions

2.27 Further to the questions posed in this consultation document, the Government would be interested in suggestions from stakeholders for any additional improvements that could be made to the administration elements of the regulatory framework for insurance companies contained in UK legislation.

3

How to respond to this consultation

3.1 The Government welcomes the views of all stakeholders on issues raised in this document. The consultation period begins with the publication of this document and will run for 12 weeks. Please ensure that responses to this consultation reach us by **25 June 2010**. We cannot guarantee to consider responses received after this date. Responses should be sent to:

Phelan Hill
HM Treasury
1 Horse Guards Road
London SW1A 2HQ

Telephone: 020 7270 6105
Fax: 020 7451 7524
Email: phelan.hill@hmtreasury.gsi.gov.uk

3.2 This document can be found on HM Treasury's website: www.hm-treasury.gov.uk

3.3 When responding, please state whether you are responding on behalf of an individual or representing the views of an organisation. If responding on behalf of a larger organisation, please make it clear who the organisation represents and, where applicable, how the views of members were assembled.

Consultation disclosure

3.4 All written responses may be made public on the Treasury's website unless the author specifically requests otherwise in writing.

3.5 Information provided in response to this consultation, including personal information, might be published or disclosed in accordance with the access to information regime. These are primarily the Freedom of Information Act 2000 (FOIA), the Data Protection Act (DPA) and the Environmental Information Regulations 2004.

3.6 If you would like the information that you provide to be treated as confidential, please be aware that, under the FOIA, there is a statutory Code of Practice with which public authorities must comply and which deals, amongst other things, with obligations of confidence. In view of this it would be helpful if you could explain to us why you regard the information you have provided as confidential. If we receive a request for disclosure of information we will take full account of your explanation, but we cannot give an assurance that confidentiality will be maintained in all circumstances.

3.7 In the case of electronic responses, general confidentiality disclaimers that often appear at the bottom of emails will be disregarded for the purpose of publishing responses unless an explicit request for confidentiality is made in the body of the response.

3.8 Subject to the previous two paragraphs, if you wish part (but not all) of your response to remain confidential, please supply two versions - one for publication on the website with the confidential information deleted, and another confidential version for use by the Treasury.

Freedom of information

3.9 Any Freedom of Information Act queries should be directed to:

Correspondence and Enquiry Unit
Freedom of Information Section
HM Treasury
1 Horse Guards Road
London SW1A 2HQ

Telephone: 020 7270 4558
Fax: 020 7270 4681
Email: public.enquiries@hmtreasury.gsi.gov.uk

Code of practice for written consultation

3.10 This consultation is being conducted in line with the Code of Practice for written consultation, which sets down the following criteria:

- formal consultation should take place at a stage when there is scope to influence the policy outcome;
- consultations should normally last for at least 12 weeks with consideration given to longer timescales where feasible and sensible;
- consultation documents should be clear about the consultation process, what is being proposed, the scope to influence and the expected costs and benefits of the proposals;
- consultation exercises should be designed to be accessible to, and clearly targeted at, those people the exercise is intended to reach;
- keeping the burden of consultation to a minimum is essential if consultations are to be effective and if consultees' buy-in to the process is to be obtained;
- consultation responses should be analysed carefully and clear feedback should be provided to participants following the consultation; and
- officials running consultations should seek guidance in how to run an effective consultation exercise and share what they have learned from the experience.]

3.11 If you feel that this consultation does not fulfil these criteria, please contact:

Angela Carden
Better Regulation Unit
HM Treasury
1 Horse Guards Road
London
SW1A 2HQ

Email: Angela.carden@hmtreasury.gsi.gov.uk

A

Modifications to the tax rules for insurers in administration

A.1 Tax rules apply in connection with insurance contracts to ensure that tax charges and reliefs apply as intended, to prevent tax avoidance and to protect the policyholder. Under the current tax regime, if the Financial Services Compensation Scheme were to intervene to assist an insurer that faced financial difficulties, there may be unintended tax impacts.

A.2 Following a review by the Government, provisions to address unintended tax impacts of investor protection schemes were introduced in the Banking (Special Provisions) Act 2008, the Banking Act 2009 and by section 33 Finance Act 2009.

A.3 Further provisions apply in connection with insurance policies. These provisions include a power to revise the tax rules to ensure tax treatment of the insurers and holders of insurance contracts with the failing insurer remain broadly the same regardless of FSCS intervention.

Adapting the pensions tax rules for an FSCS intervention

A.4 Life insurance companies can make pensions payments and are the only institutions that are authorised to issue annuities - a financial product where a lump sum investment is exchanged for a regular payment of income for life in retirement. Where insurance companies register a pension scheme they have to abide by the relevant tax rules.

A.5 Recently the tax rules were reviewed and the Government introduced regulation-making powers under section 74 Finance Act 2009 so that if an insurer were to face financial difficulties, the Treasury could exercise a power to ensure that no unintended tax charges would arise where the FSCS intervenes in relation to pension savings by taking actions to assist the insurer.

A.6 The power can be applied retrospectively provided that the regulations do not increase any person's tax liability or impose a tax obligation.

Adapting the tax rules for FSCS interventions in relation to non-pension insurance contracts

A.7 For other protected insurance contracts (i.e. general and non-pension life contracts), a number of unintended tax impacts may also arise under existing tax rules if the FSCS were to intervene to assist an insurer facing financial difficulties.

A.8 The Chargeable Event Gain regime (which applies income tax to gains from life insurance policies) is likely to be most affected, but there may also be impacts for the tax advantaged Qualifying Policy regime, Friendly Society Tax Exempt Savings Plans (TESPs) and other areas.

A.9 The Government intends to introduce regulation making powers similar to those in section 74 Finance Act 2009 such that the Treasury is able, by regulations, to adapt tax treatment in connection with FSCS interventions for life (non-pension) and general insurance policies. The Government considers that this approach will ensure consistency in terms of tax treatment between the pension-related insurance policies and the non-pension insurance products.

B

List of consultation questions

Valuing contracts of insurance

- 1 Do you agree that the valuation rules set out in the Insurers (Winding Up) Rules 2001 should be applied to insurance companies in administration?

Revising the objectives of the administrator of an insolvent insurance company

- 2 Do you agree that the administrator should have a duty to provide assistance to the FSCS to enable it to administer the compensation scheme?
- 3 Do you consider that the administrator should have a duty to provide assistance to the FSCS to enable it to secure continuity of long-term insurance contracts?
- 4 Do you consider that the duty to assist the FSCS in securing continuity of insurance contracts should also apply in relation to general insurance contracts?

Continuity and variation of long-term contracts during administration

- 5 Do you agree that the administrator should be required to maintain contracts of long-term insurance?
- 6 Do you consider that an administrator should be permitted to enter into new contracts of long-term insurance where it relates to existing policyholders and arrangements in place?
- 7 Do you agree that the power to agree variation of contracts in force should be given to the administrator?

The appointment of Special Manager

- 8 Do you agree that the administrator should have the same power to apply to the courts for the appointment of a Special Manager, as currently held by the liquidator?

Reducing the value of contracts of long-term insurance in administration

- 9 Do you agree that the courts should be given the power to reduce the value of contracts and to appoint an independent actuary, in the event of an insurer going into administration?



Impact Assessment

Impact Assessment follows on the next page.

Summary: Intervention & Options

Department /Agency: HM Treasury	Title: Impact Assessment on the proposals to strengthen the administration regime for insurers	
Stage: Consultation	Version: 1	Date: 25 March 2010
Related Publications: Financial Services and Markets Act 2000 and the Insolvency Act 1986		
Available to view or download at: http://www.hm-treasury.gov.uk		
Contact for enquiries: Phelan Hill		Telephone: 020 7270 6105

What is the problem under consideration? Why is government intervention necessary?

Currently under the insolvency regimes for insurers, policyholders are afforded less protection when an insurer is in administration than when it is in liquidation. This could result in, for example, a significant delay of payment of benefits to policyholders. As many policyholders (in particular those with long-term contracts of insurance, which include annuities and life policies) rely upon payments under these policies as their main source of income or protection to cover their liabilities.

What are the policy objectives and the intended effects? The Government seeks to strengthen the administration regime for insurers (in particular, those that issue long-term insurance products), by providing legal certainty for administrators and policyholders through:

- applying the existing rules for valuing contracts of insurance in liquidation to administration; and
- revising the objectives of an administrator of an insurance company, by:
 - changing the law to require administrators to provide assistance to the FSCS to enable it to administer the compensation scheme and secure continuity of contracts of insurance; and
 - applying existing powers relating to continuity of contracts of long-term insurance on the winding-up of an insurer to administration.

What policy options have been considered? Please justify any preferred option.

- Option 1 - do nothing (maintain the status quo).
- Option 2 - amend the administration regime for insurers to provide holders of insurance contracts equivalent protection under insolvency law when an insurer is in liquidation to an insurer in administration.

The preferred option is to option 2, as it provides insurance policyholders, in particular those with long-term contracts of insurance, increased security of continuity of payments and overall protection when an insurer is in administration. This refinement to the administration regime should further promote overall market confidence, through continuity of benefit and compensation payments, protection and the ability to collect premiums, if an insurer were to face financial difficulties.

When will the policy be reviewed to establish the actual costs and benefits and the achievement of the desired effects? This legislation will be reviewed on an annual basis as part of the FSA's review of FSMA

Ministerial Sign-off For consultation stage Impact Assessments:

I have read the Impact Assessment and I am satisfied that, given the available evidence, it represents a reasonable view of the likely costs, benefits and impact of the leading options.

Signed by the responsible Minister:



..... Date: 25 March 2010.....

Summary: Analysis & Evidence

Policy Option: 2	Description: refining the administration regime for insurers to improve the continuity of payments and protection for policyholders should an insurer go into administration.
-------------------------	--

COSTS	ANNUAL COSTS		Description and scale of key monetised costs by 'main affected groups' There are no significant ongoing or one-off direct costs associated with these measures
	One-off (Transition)	Yrs	
	£ n/a	1	
	Average Annual Cost (excluding one-off)		
	£ n/a		
Total Cost (PV)			£ n/a
Other key non-monetised costs by 'main affected groups': The main affected groups would be the administrators of insurers. The proposed modifications align the administration regime to provisions that currently exist under the liquidation regime for insurers, thereby offering policyholders improved protection and continuity of benefit payments and compensation, as appropriate. It is likely that the administrator would act in similar manner as prescribed under the liquidation regime without these modifications, and therefore the cost impact of these changes would be modest. The modification, however, remove any uncertainty of the administrators approach should an insurer face financial difficulties.			

BENEFITS	ANNUAL BENEFITS		Description and scale of key monetised benefits by 'main affected groups' It is not feasible to quantify the benefits of these measures. However, there are significant benefits of ensuring that if an insurer were to fail, the administration is conducted an orderly fashion. These are set out in the evidence base.
	One-off	Yrs	
	£ n/a	1	
	Average Annual Benefit (excluding one-off)		
	£ n/a		
Total Benefit (PV)			£ n/a
Other key non-monetised benefits by 'main affected groups': The main affected groups are holders of policies with an insurer in administration (who will receive the same level of protection as under the liquidation regime) of long-term insurance contracts and participants in the wider economy. If an insurer were to face financial difficulties, the modifications to the regime (under option 2) should promote overall market confidence; as well as instilling confidence in the insolvent firm, by ensuring continuity of payments with a significant delay, and protection to policyholders. This in turn would increase the likelihood of the business of the firm to be sold/transferred			

Key Assumptions/Sensitivities/Risks Given that over the last 10 years no insurance firm has gone into insolvency, we also assume the likelihood of future occurrences to be low.

Price Base Year 2009	Time Period Years 10	Net Benefit Range (NPV) £ 0	NET BENEFIT (NPV Best estimate) £ 0
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What is the geographic coverage of the policy/option?				United Kingdom	
On what date will the policy be implemented?				TBC	
Which organisation(s) will enforce the policy?				FSA, FSCS	
What is the total annual cost of enforcement for these organisations?				£ Not known	
Does enforcement comply with Hampton principles?				Yes	
Will implementation go beyond minimum EU requirements?				N/A	
What is the value of the proposed offsetting measure per year?				£ N/A	
What is the value of changes in greenhouse gas emissions?				£ N/A	
Will the proposal have a significant impact on competition?				No	
Annual cost (£-£) per organisation (excluding one-off)		Micro 0	Small 0	Medium 0	Large 0
Are any of these organisations exempt?		No	No	N/A	N/A

Impact on Admin Burdens Baseline (2005 Prices)				(Increase - Decrease)	
Increase of	£ No impact	Decrease of	£ No impact	Net Impact	£ No impact

Key: Annual costs and benefits: Constant Prices (Net) Present Value

Evidence Base (for summary sheets)

Objectives

1. The insolvency regime for insurers has evolved over time. This has resulted in potential gaps in the provision and protection for insurance policyholders (in particular those with long-term contracts, such as annuities and life policies) of an insurer that is put into administration in comparison to when it is put into liquidation.
2. As part of wider work to review the landscape of the financial sector, and reflecting on lessons learnt during the financial crisis, the Government considers that there are a number of areas of the administration regime for insurers that could be strengthened with a view to improving the continuity of payments and protection for protected insurance policyholders.
3. If an insurer were to be placed in administration under the current regime, policyholders may be disadvantaged by, for example, a significant delay in the payment of benefits, no continuity in protection, loss of benefits and additional costs in moving to new contracts. As many policyholders rely upon payment of benefits under these policies as their main source of income, as well as the protection they offer against certain possible liabilities, this could cause hardship to a number of vulnerable sectors of the population if continuity of payments and protection for policyholders were not achieved.
4. Although, when an insurer is put in administration, an administrator may apply the rules under the liquidation regime for insurers, there is no certainty that this would happen.
5. The Government seeks views on whether to refine the administration regime for insurers to improve the continuity of payments and protection for policyholders should an insurer go into administration, in particular, by:
 - a. adopting certain aspects of the liquidation regime for contracts of long-term insurance incorporated in section 376 of Financial Services and Markets Act 2000 (FSMA), and under the Insolvency Act 1986 and the Insurers (Winding Up) Rules 2001; and
 - b. adding specific duties to the objectives of the administrator of an insurer in addition to those currently required under Schedule B1 to the Insolvency Act 1986.

Background

The UK insurance sector

6. The UK insurance industry is a key part of the UK financial services sector and is the second largest insurance industry worldwide. It accounts for 11 per cent of premiums globally and, in 2008, it controlled 13.4 per cent of the UK stock market.¹
7. Insurance companies currently offer two main types of contracts of retail insurance:
 - a. long-term: this covers life insurance products which include personal pensions and pure protection contracts (such as term, income protection and critical illness insurance); and
 - b. general: this includes both compulsory insurance (such as motor third party insurance and employers' liability insurance) and non-compulsory insurance such as household and private medical insurance.
8. There are 972 companies authorised by the Financial Services Authority (FSA) to carry out insurance business in the UK. Of these:
 - a. 735 carry out general business only (which includes, for example, motor, household and commercial insurance);
 - b. 193 carry out long-term business only (such as life insurance and pensions); and
 - c. 44 carry out both general and long-term business.

¹ Source: Association of British Insurers Key Facts September 2009

Insurers in insolvency

9. The number of incidences of insurers being put into administration or being wound-up in the UK have been low, with no further incidents occurring during the recent period of financial instability. The last case of a life insurance company going into liquidation was Oaklife Assurance Company, in September 1993. As a result the procedures and processes surrounding insurers entering into administration have not been developed significantly either in practice or in law.
10. Although the UK capital regime of insurers has successfully absorbed unexpected losses and has avoided failure of an insurance undertaking, neither the current nor any future solvency regime would be able to create a zero-failure environment for insurance companies.

The evolution of the administration regime for insurers

The Insolvency Act 1986

11. The Insolvency Act 1986 did not permit an insurance company to be put into administration. It was considered that administration would not be an appropriate procedure for insurers:
 - a. given the different nature of insurance business, in particular for those businesses that provide insurance policies with long-term contracts;² and
 - b. as there were a number of existing alternative provisions for insurers in, for example, the Insurance Companies Act 1982, and the Insurance Companies (Winding-Up) Rules 1985, specific provisions for administration were not necessary.

The Financial Services and Markets Act 2000

12. The Financial Services and Markets Act 2000 (FSMA) established a new, single regime for the statutory regulation of financial services, including insurers in the UK, and established the FSA as the single statutory regulator for financial services.
13. Section 360 of FSMA gave HM Treasury (the Treasury) the power to modify Part II (Administration Orders) of the Insolvency Act 1986 to allow insurers to be placed in administration. In 2002, the Government made use of this power and through the Financial Services and Markets Act 2000 (Administration Orders Relating to Insurers) Order 2002 some modifications were made to extend the administration regime to insurers. This new administration regime for insurers was aligned with certain aspects of the liquidation regime for insurers.

The Financial Services Compensation Scheme for insurers

14. The Financial Services Compensation Scheme (FSCS), which was established under FSMA, acts as the UK's compensation fund of last resort for customers of financial services firms (which include credit institutions and insurers). This means that the FSCS protects consumers, if an authorised financial services firm were unable, or were likely to be unable, to pay claims against it.

² As administration is a collective procedure, an administrator is specifically required to carry out his or her functions in the interests of the company's creditors as a whole; where there is insufficient resources available to pay unsecured creditors (such as insurance policyholders) in full, an administrator can only act in a way that does not unnecessarily harm the interests of the creditors of the company as a whole. It was considered that this approach would have a negative impact on insurance policyholders, particularly those with long-term contracts (such as life and annuity policies), who rely upon the cash-flows from their matured policies as their main source of income.

15. For insurers, the FSCS is the successor to the Policyholders Protection Board. One of the FSCS triggers for the insurance sector includes the appointment of an administrator. Once triggered, the FSCS under the Compensation (COMP) Sourcebook of the FSA Handbook (COMP 3.3.1-3.3.2 - made under section 216 of FSMA)) is required to make arrangements to secure continuity of insurance for eligible claimants who have protected life insurance contracts and has the power to make such arrangements for protected contracts of general insurance.
16. The maximum FSCS compensation for policyholders of an insurer in administration is 90 per cent of the claim for protected life insurance contracts (if continuity cannot be secured) and for protected general insurance contracts. Compulsory insurance is protected in full. For the process to work efficiently, it is important that the administrator provides assistance to the scheme manager of the FSCS in its role as scheme manager, to ensure that the FSCS has access to the administrative resources of the insurer.
17. The FSCS must make arrangements to secure continuity for insurance contracts if:
 - a. it is reasonably practicable to do so; and
 - b. the FSCS is satisfied that the arrangements would be beneficial to the generality of the eligible claimants covered by the arrangements.
18. The FSCS must ensure that the claimant will receive at least 90 per cent of the benefits under the policyholder's previous contract (if the FSCS secures less than 100 per cent of the benefits under a contract, the FSCS must ensure that any future premiums are reduced by an equivalent amount).
19. For general insurance contracts and life insurance contracts where the FSCS is not securing continuity, the FSCS may take measures to safeguard policyholders of an insurance company that is in financial difficulty. FSCS must secure that life insurance benefits falling due after the default are paid whilst it explores the continuity options.

Rationale for intervention

20. Despite the low number of insolvencies in the insurance sector, distinct gaps remain in the administration regime for insurers in comparison to the liquidation regime. This means that policyholders, in particular those with long-term contracts of insurance, would not receive equivalent protection under insolvency law when an insurer is in administration as opposed to when the insurer goes into liquidation.
21. These disparities include the fact that:
 - a. there are no rules for the valuation of general or long-term insurance contracts in administration, resulting in a lack of clarity on how to deal with these contracts once an insurer defaults; and
 - b. although an administrator currently has the power to:
 - provide assistance to enable the FSCS to administer the compensation scheme and secure continuity of contracts of insurance; and
 - continue the business of the insurer and make payments under any policies;the administrator is not required to do so.
22. Although, if an insurer were to be put into administration, an administrator may apply the valuation rules applying on the liquidation of an insurer, and may provide assistance to the FSCS, there is no certainty that this would happen.

Intended effect

23. The proposed modifications to the insolvency regime of insurers aims to:
 - a. provide legal certainty of the procedures and process for both policyholders and an administrator of an insurer in administration;

- b. ensure insurance policyholders who have contracts with an insurer facing financial difficulties receive continuity of protection and continuity of benefit payments, without any significant delay;
- c. secure the continuity of business (by the administrator, or where appropriate the FSCS) through continued ability to collect premiums, instilling confidence in the insurer, facilitating the sale/transfer of the insolvent insurer's business; and
- d. promote overall market confidence should an insurer face financial difficulty.

Options

24. There are two options:

- a. **Option 1** – do nothing
- b. **Option 2** – modify the administration regime for insurers, by:
 - applying the existing rules for valuing contracts of insurance in liquidation to administration; and
 - revising the objectives of administrators.

Option 1 – Do nothing

25. Option 1 is to leave the insolvency regime for insurers unchanged. This would retain the disparity between the protection afforded to insurance policyholders under the administration and liquidation regimes of insurers. An insurer facing financial difficulties and entering into administration could lead to a loss of confidence in the company and consumer detriment to policyholders.

Costs

26. There are no monetary costs with option one as it maintains the status quo.

27. However should there be no change and an insurer be placed in administration:

- a. policyholders may be subject to significant delays in payments and protection, as the administrator would not have duty to:
 - provide assistance to the FSCS to enable it to administer the compensation scheme and secure continuity of contracts of insurance; or
 - apply continuity of contracts of long-term insurance

Many policyholders rely on insurance policies as their main source of income, and any delay may result in hardship and anxiety as a result. Without the immediate continuation of protection, policyholders would be exposed to liabilities for which the insurance policy afforded protection;³

- b. contracts of insurance may lapse due to the lack of immediate continuity insurance contracts. This would be disadvantageous to those whose personal circumstances have deteriorated (for example through illness) since inception of the policies, as they would be unable to obtain equivalent policies, in relation to terms and pricing, with new insurers;
- c. loss of confidence in the company, the wider insurance sector and the financial markets as a whole may result, as policyholders the insurance sector. This could lead to the deepening of financial markets, and financial stability risks; and
- d. loss of confidence in the sector may not only increase the number of insurers defaulting, as policyholders surrender their policies en masse, but it would make it even more difficult to sell/transfer the business of the firm.

Benefits

28. Without these duties placed on the administrator of an insurer, the other unsecured creditors (i.e. non-insurance policyholders) would continue to benefit from being treated on the same level as insurance policyholders.

³ The Association of British Insurers reported that there were over 47 million in force life policies at 31 December 2007. Payments in benefits to pensioners and long-term savers, or in death and disability benefits in 2007 amounted to £77 billion. Rough estimations show that the average life policy is around £11,000 although this may vary.

Option 2 – modify the administration regime for insurers

29. The proposed modifications to the insolvency regime for insurers aims to:
- a. provide legal certainty in terms of procedure and process for both the policyholder and administrator of an insurer in administration;
 - b. ensure insurance policyholders who have contracts with an insurer facing financial difficulties receive continuity of protection and of payment, without any significant delay, should an insurer be put into administration;
 - c. secure continuity of business through the continued ability to collect premiums, which would instilling confidence in the insurer and should, therefore facilitate the sale/transfer of the insolvent insurer's business; and
 - d. promote overall market confidence should an insurer face financial difficulty.
30. The proposed modifications are to:
- a. apply the existing rules for valuing contracts of insurance in liquidation to administration; and
 - b. revise the objectives of administrators.

Valuation of insurance contracts

31. Although the Financial Services and Markets Act 2000 (Administration Orders Relating to Insurers) Order 2002 modified the administration regime for insurers to some degree, it did not provide a comprehensive regime for insurers. The rules for valuation of both general and long-term contracts in the event of a winding-up under the Insurers (Winding Up) Rules 2001, for example, do not apply when an insurer goes into administration.

Objectives of the administrator of an insurer:

- *Providing assistance to the FSCS*
32. When an insurer faces financial difficulties, the FSCS plays an important role in providing compensation and continuity of payment, as well as protection, for policyholders with general and/or long-term contracts of insurance. Given that some policyholders rely on the insurance benefit payments, any significant delays in these payments could result in hardship.
33. For the FSCS process to work efficiently, it is considered that an administrator should be required to provide assistance to the FSCS to enable it to administer the scheme and to secure continuity of long-term insurance contracts, mobilising the administrative resources of the insurer.
- *Continuation of long-term contracts*
34. Section 376 of FSMA ensures that, where possible, long-term insurance contracts will continue where an insurer goes into liquidation. Unless otherwise directed by a court, the liquidator is required to maintain existing contracts so that they may be transferred to another insurer as a going concern. The section provides the liquidator with the necessary powers.
35. In contrast, when an insurer is in administration, although an administrator currently has the power to continue the business of the insurer (activities of which includes collection of premiums, managing investments and the payment of benefits under any policies), the administrator is not required to do so.
36. In the majority of cases, terms and pricing of insurance policies are set at inception of a contract. If the continuity of policies of long-term contracts is not preserved (i.e. if they terminate or lapse early due to, for example, the insurer becoming insolvent), the

policyholder could be disadvantaged, suffer loss of benefits and face additional costs in replacing the benefits. When an insurer becomes insolvent, the personal circumstances of the policyholder at that time may have changed to such a degree from when he or she entered into the contract that they are unable to obtain equivalent replacement policies, in relation to terms and price, from another insurer.

Costs

37. There are no significant on-going or one-off direct costs associated with option two. In addition this event is, likely to be infrequent due to the robust nature of the prudential regulatory regime for insurers in the UK.
38. This option requires the administrator of an insurer:
- a. to continue making payments under contracts of long-term insurance, in the absence of a court order relieving the administrator from that duty. In the first instance, these payments will be drawn from the resources of the company, reducing the assets available to satisfy other unsecured creditors; and
 - b. to provide assistance to the FSCS to enable it to administer the compensation scheme and secure continuity of contracts of insurance.
39. These provisions currently exist under the liquidation regime for insurers. It is likely that the administrator would act in similar manner as prescribed under the liquidation regime for insurers and therefore the cost impact of these changes would not be significant.

Benefits

40. Benefits of option two include:
- a. greater certainty for administrators of which rules to apply while valuing general and long-term insurance contracts during an administration;
 - b. increased protection for long-term policyholders. The duty on administrators to carry on the insurer's contracts of long-term insurance, and to provide assistance to the FSCS in securing continuity of contracts will benefit policyholders with the continuation of protection and payments due under such policies without any significant delay;
 - c. increased efficiency of assessment and payment of claims under the scheme by FSCS due to the required assistance of the administrator; and
 - d. greater confidence in the insurance sector if an insurer were to fail, reducing the number of policyholders surrendering their policies.

Discussion and risk

41. The UK insurance industry is a key part of the UK financial services sector and is the second largest insurance industry worldwide. It accounts for 11 per cent of premiums globally⁴ and, in 2006, it controlled 15 per cent of the UK stock market.
42. Currently, there are 1,017 companies authorised by the Financial Services Authority (FSA) to carry out insurance business in the UK.
43. The incidences of insurers being put into administration or being wound-up in the UK have been low, with no further incidents occurring during the recent period of financial instability. The Government, however, considers that the administration regime for insurers should be strengthened, in light of the lessons learnt during the financial crisis in relation to the banking sector and as the prudential regime for insurers in the UK, even though it has proved to be robust, is not able to create a zero-failure environment.
44. The aim of refining the administration regime would be to ensure that policyholders continue to receive the payments due from their contracts with the insurer in administration without any significant delay and thus reducing any potential hardship arising from delayed payments. With this assurance, the loss of confidence in the insurer is likely to be reduced, increasing the likelihood of the insurer's business to be sold/transferred.
45. The policyholder of long-term insurance contract would bear the risk if the administration regime for insurers remains unchanged (option 1). This would likely lead to the loss of confidence in the insurer, and reducing the ability to continue the business of the insolvent insurer.
46. After considering the risks, costs, and benefits, the Government's preferred option is option two.

Implementation timetable

47. The Order modifying the administration regime for insurers is subject to negative procedures, whereby it is adopted 21 days after it is laid before Parliament, provided no objections are made. Once the responses to the consultation have been considered and, where appropriate, the Order is amended, the final Order, subject to Ministerial approval, will be made and laid in front of Parliament.

Monitoring, enforcement and sanctions

48. The Financial Services Authority (FSA) will be responsible for the monitoring and enforcement of this Order. The FSA would be able to place sanctions, as prescribed under the Financial Services and Markets Act 2000 (FSMA), as necessary.

Post implementation review

49. This legislation will be reviewed on an annual basis as part of the FSA's review on FSMA.

Specific impact assessment

Impact on small firms

50. We have evaluated the options discussed above against the Small Firms impact assessment guidelines. The Government considers that this order will not have any significant impact on small firms because the legislation is already in existence.

Competition Assessment

51. Based upon the OFT Competition Impact Assessment guidelines, this reform does not have any impact on competition since it puts an obligation on all insurance providers and only comes into effect when an insurance provider goes into insolvency. Furthermore, since the

⁴ Source: Association of British Insurers Key Facts September 2008

likelihood of insolvency is minimal (no cases over the last 10 years), it is unlikely that the obligations to come into force.

Race, disability, gender and human rights

52. This order will have no impact on race, disability, gender or human rights.

Specific Impact Tests: Checklist

Type of testing undertaken	<i>Results in Evidence Base?</i>	<i>Results annexed?</i>
Competition Assessment	Yes	No
Small Firms Impact Test	Yes	No
Legal Aid	No	No
Sustainable Development	No	No
Carbon Assessment	No	No
Other Environment	No	No
Health Impact Assessment	No	No
Race Equality	Yes	No
Disability Equality	No	No
Gender Equality	No	No
Human Rights	No	No
Rural Proofing	No	No

D

Draft Statutory Instrument

Draft Statutory Instrument follows on the next page.

2010 No.

FINANCIAL SERVICES AND MARKETS

The Financial Services and Markets Act 2000 (Administration Orders Relating to Insurers) Order 2010

Made - - - - ***
Laid before Parliament ***
Coming into force - - ***

The Treasury, in exercise of the powers conferred on them by sections 360, 426(1) and 428(3) of the Financial Services and Markets Act 2000(a), with the consent of the Secretary of State, make the following Order:

Citation, commencement and interpretation

1.—(1) This Order may be cited as the Financial Services and Markets Act 2000 (Administration Orders Relating to Insurers) Order 2010 and comes into force on [].

(2) In this Order—

“the 1986 Act” means the Insolvency Act 1986(b);

“initial creditors' meeting” has the meaning given by paragraph 51(1) of Schedule B1;

“Schedule B1” means Schedule B1 to the 1986 Act(c).

Modification of Part 2 of the 1986 Act in relation to insurers

2.—(1) Part 2 of the 1986 Act (administration), other than paragraph 14 of Schedule B1 (power of holder of floating charge to appoint administrator) and paragraph 22 of Schedule B1 (power of company or directors to appoint administrator), applies in relation to insurers with the modifications specified in the Schedule to this Order.

(2) Accordingly paragraph 9(2) of Schedule B1 does not preclude the making of an administration order in relation to an insurer.

Modification of the Insolvency Rules 1986 in relation to insurers

3. The Insolvency Rules 1986(d), so far as they give effect to Part II of the 1986 Act, have effect in relation to insurers with the following modifications—

(a) in Rule 2.12(1) (the hearing) after sub-paragraph (a) insert—

(a) 2000 c.8.

(b) 1986 c. 45.

(c) Schedule B1 to the Insolvency Act 1986 was inserted by section 248 of, and Schedule 16 to, the Enterprise Act 2002 (c. 40).

(d) S.I. 1986/1925. Rule 2.12 was substituted by S.I. 2003/1730. Rule 4.90 was substituted by S.I. 2005/527. There are other amending instruments, but none is relevant.

- “(aa) the Financial Services Authority;
- (bb) the scheme manager of the Financial Services Compensation Scheme;”;
- (b) after Rule 2.81(1) (estimate of quantum) insert—
 - “(1A) Where the debt being estimated under paragraph (1) relates to an insurance policy, the value of that policy shall be estimated—
 - (a) in accordance with rule 6 of, and Schedule 1 to, the Insurers (Winding Up) Rules 2001(a) where the policy concerned is a contract of general insurance, and
 - (b) in accordance with rule 7 of, and Schedules 2 to 4 to, the Insurers (Winding Up) Rules 2001 where the policy concerned is a contract of long-term insurance.”
- (c) after Rule 2.81(2) insert—
 - “(3) In this Rule “contract of general insurance” and “contract of long-term insurance” have the meaning given by article 3(1) of the Financial Services and Markets Act 2000 (Regulated Activities) Order 2001(b).”

Revocation

4. The following are revoked—
- (a) the Financial Services and Markets Act 2000 (Administration Orders Relating to Insurers) Order 2002(c);
 - (b) articles 1 to 8 of the Financial Services and Markets Act 2000 (Administration Orders Relating to Insurers)(Amendment) Order 2003(d);
 - (c) regulation 52 of the Insurers (Reorganisation and Winding Up) Regulations 2004(e).

Saving

5. Nothing in articles 2 to 5 applies in relation to any case where the appointment of an administrator takes effect before the coming into force of this Order.

	<i>Name</i>
	<i>Name</i>
Date	Two of the Lords Commissioners of Her Majesty’s Treasury

I consent	<i>Name</i>
	Minister for Employment Relations and Postal Affairs
Date	Department for Business, Innovation and Skills

SCHEDULE Article 2

Modifications of Part 2 of the Insolvency Act 1986 in relation to Insurers

- 1.—(1) In paragraph 3 of Schedule B1 (purpose of administration)—
- (a) at the beginning of sub-paragraph (1) insert “Subject to sub-paragraph (1A)”;
 - (b) after sub-paragraph (1) insert—

(a) S.I. 2001/3656, amended by S.I. 2003/1102 and S.I. 2004/546.
 (b) S.I. 2001/544. Article 3 of S.I. 2001/544 has been amended by a number of instruments, but none of the amendments affect the meaning of the terms cited here.
 (c) S.I. 2002/1242.
 (d) S.I. 2003/2134.
 (e) S.I. 2004/353.

“(1A) The administrator of an insurer which effects or carries out contracts of insurance shall, at the request of the scheme manager of the Financial Services Compensation Scheme, provide any assistance identified by the scheme manager as being necessary—

- (a) to enable the scheme manager to administer the compensation scheme in relation to contracts of insurance, and
- (b) to enable the scheme manager to secure continuity of insurance in relation to contracts of long-term insurance.

(1B) For the purposes of this schedule—

- (a) “compensation scheme” has the same meaning as in section 213 of the Financial Services and Markets Act 2000(a),
- (b) “contracts of insurance” and “contracts of long-term insurance” have the same meaning as in Article 1 of the Financial Services and Markets Act 2000 (Regulated Activities) Order 2001(b);
- (c) “scheme manager” means the body corporate established by the Financial Services Authority under section 212 of the Financial Services and Markets Act 2000.”.

(2) In sub-paragraph (2), for “sub-paragraph (4),” substitute “sub-paragraphs (1A) and (4) and to paragraph 3A”.

2.—(1) After paragraph 3 of Schedule B1, insert—

“3A.—(1) This paragraph applies in relation to the administration of an insurer which effects or carries out contracts of long-term insurance.

(2) Unless the court orders otherwise, the administrator must carry on the insurer’s business so far as that business consists of carrying out the insurer’s contracts of long term insurance (“the long-term insurance business”) with a view to the business being transferred as a going concern to a person who may lawfully carry out those contracts.

(3) In carrying on the long-term insurance business, the administrator—

- (a) may agree to the variation of any contracts of insurance in existence when the administration order is made; but
- (b) must not effect any new contracts of insurance.

(4) If the administrator is satisfied that the interests of the creditors in respect of liabilities of the insurer attributable to contracts of long-term insurance effected by it require the appointment of a special manager, the administrator may apply to the court.

(5) On such an application, the court may appoint a special manager to act during such time, and to have such powers (including powers of a receiver or manager) as the court may direct.

(6) Section 177(5) (duties of special manager) of this Act applies to a special manager appointed under sub-paragraph (5) as it applies to a special manager appointed under section 177.

(7) If the court thinks fit, it may reduce the value of one or more of the contracts of long-term insurance effected by the insurer.

(8) Any reduction is to be on such terms and subject to such conditions (if any) as the court thinks fit.

(9) The court may, on the application of an official, appoint an independent actuary to investigate the insurer’s long-term insurance business and to report to the official—

- (a) on the desirability or otherwise of the insurer’s long-term insurance business being continued; and

(a) 2000 c. 8. Part VII has been amended by section 15 of and Schedule 2 to, the Dormant Bank and Building Society Accounts Act 2008, and by S.I. 2004/3379, 2006/745, 2007/3253, 2008/948, and 2008/1468.

(b) S.I. 2001/544, to which there are amendments not relevant to this Order.

- (b) on any reduction in the contracts of long-term insurance effected by the insurer that may be necessary for successful continuation of the insurer's long-term insurance business.

(10) "Official" means—

- (a) the administrator;
- (b) a special manager appointed under sub-paragraph (5); or
- (c) the Authority."

3. In paragraph 49(4) of Schedule B1 (administrator's proposals), at the end of paragraph (c) add—

- "(d) to the Financial Services Authority, and
- (e) to the scheme manager of the Financial Services Compensation Scheme."

4. In paragraph 53(2) of Schedule B1 (business and result of initial creditors' meeting), at the end of paragraph (c), add—

- "(d) the Financial Services Authority, and
- (e) to the scheme manager of the Financial Services Compensation Scheme."

5. In paragraph 54(2)(b) of Schedule B1 (revision of administrator's proposals), after "creditor" insert ", to the Financial Services Authority and to the scheme manager of the Financial Services Compensation Scheme."

6. In paragraph 76(1) of Schedule B1 (automatic end of administration), for "one year" substitute "30 months".

7. In paragraph 76(2)(b) of Schedule B1 (extension of administrator's term of office by consent) for "six" substitute "twelve".

8. In paragraph 79(1) of Schedule B1 (court ending administration on application of administrator), after the first reference to "company" insert "or the Financial Services Authority".

9. In paragraph 91(1) of Schedule B1 (supplying vacancy in office of administrator), at the end of paragraph (e) add—

- ", or
- (f) the Financial Services Authority".

10.—(1) The powers of the administrator referred to in Schedule 1 to the 1986 Act (powers of administrator or administrative receiver) include the power to make—

- (a) any payments due to a creditor; or
- (b) any payments on account of any sum which may become due to a creditor.

(2) Any payments to a creditor made pursuant to sub-paragraph (1) must not exceed, in aggregate, the amount which the administrator reasonably considers that the creditor would be entitled to receive on a distribution of the insurer's assets in a winding up.

(3) The powers conferred by sub-paragraph (1) may be exercised until an initial creditors' meeting but may only be exercised thereafter—

- (a) if the following conditions are met—
 - (i) the administrator has laid before that meeting or any subsequent creditors' meeting ("the relevant meeting") a statement containing the information mentioned in sub-paragraph (4); and
 - (ii) the powers are exercised with the consent of a majority in number representing three-fourths in value of the creditors present and voting either in person or by proxy at the relevant meeting; or
- (b) with the consent of the court.

(4) The information referred to in sub-paragraph (3)(a) is an estimate of the aggregate amount of—

- (a) the insurer's assets and liabilities (whether actual, contingent or prospective); and
- (b) all payments which the administrator proposes to make to creditors pursuant to sub-paragraph (1);

including any assumptions which the administrator has made in calculating that estimate.

EXPLANATORY NOTE

(This note is not part of the Order)

This Order consolidates the Financial Services and Markets Act 2000 (Administration Orders Relating to Insurers) Order 2002 (S.I. 2002/1242) and its amending instruments, applying Part II of the Insolvency Act 1986 in relation to insurers, and makes further modifications to Schedule B1 to that Act.

Article 2 enables administration orders to be made in relation to insurers, applying Part II of the Insolvency Act 1986 to insurers with the modifications set out in the Schedule.

Article 3 modifies the Insolvency Rules 1986, ensuring that the same rules apply for the valuation of an insurance policy on administration and winding up.

Article 4 revokes the orders which previously applied Part 2 of the Insolvency Act 1986 to insurers.

An Impact Assessment of the effect of this Order is available on HM Treasury's website (hm-treasury.gov.uk).

HM Treasury contacts

This document can be found in full on our website at:

hm-treasury.gov.uk

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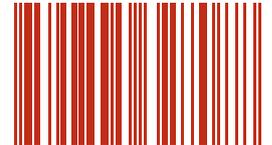
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