

EXPLANATORY MEMORANDUM TO
THE FINANCIAL SERVICES AND MARKETS ACT 2000 (ADMINISTRATION
ORDERS RELATING TO INSURERS) ORDER 2010

2010 No. 3023

1. This explanatory memorandum has been prepared by HM Treasury and is laid before Parliament by Command of Her Majesty.

This memorandum contains information for the Joint Committee on Statutory Instruments.

2. **Purpose of the instrument**

2.1 Is to consolidate the Financial Services and Markets Act 2000 (Administration Orders relating to Insurers) Order 2002 (S.I. 2002/1242) (“the 2002 Order”) and its amending instruments, and to make further modifications to the application of Part II of the Insolvency Act 1986 to insurers.

3. **Matters of special interest to the Joint Committee on Statutory Instruments**

3.1 None.

4. **Legislative Context**

4.1 Part II of the Insolvency Act 1986 as inserted by the Enterprise Act 2002 provide a regime for the administration of a company on insolvency. The 2002 Order enabled that regime to be applied to insurers, and made a number of modifications to Part II. The 2002 Order was subsequently amended by the Financial Services and Markets Act 2000 (Administrative Orders Relating to Insurers) (Amendment) Order 2003 to reflect the changes to the administration regime made by the Enterprise Act 2002, which amended Part II of the 1986 Act, and inserted Schedule B1 to the Act. It has also been amended by the Insurers (Reorganisation and Winding Up) Regulations 2004 (S.I. 2004/353).

4.2 This Order consolidates the modifications made to Part II of the Insolvency Act 1986 in relation to insurers and makes further modifications:

- Imposing a duty on the administrator of an insurer to assist the Financial Services Compensation Scheme in administering the compensation scheme in relation to contracts of insurance, and in securing continuity of insurance in relation to contracts of long-term insurance.
- Ensuring that an administrator of an insurer is subject to the same duties as liquidator to carry on the insurer’s business as far as it relates to contracts of long-term insurance.

5. Territorial Extent and Application

5.1 This instrument applies to Great Britain.

6. European Convention on Human Rights

6.1 This Order is subject to the negative resolution procedure and does not amend primary legislation, therefore no compatibility statement is required in relation to it.

7. Policy background

• *What is being done and why*

7.1 During the recent financial crisis, as part of the wider work on contingency planning, a review was undertaken on the administrative and insolvency regime for insurers. A number of gaps and issues were identified with the current regime, which could lead to significant delays in continuity of benefit payments (such as annuity payments) and protection for policyholders should an insurer be put in administration. It was further considered that potential contagion risks could arise if a major insurer were to fail and these gaps in the regime were not addressed.

7.2 Policyholders, especially those with long-term contracts of insurance, currently do not receive equivalent protection under insolvency law when an insurer is in administration, to which they would receive were the insurer to go into liquidation. For example:

- while an administrator has the power to provide assistance to enable the FSCS to administer the compensation scheme and secure continuity of contracts of insurance, it is not required to do so; and
- while the administrator may continue the business of the insurer and make payments under any policies, it is not required to do so.

7.3 A 12-week consultation was launched on 26 March 2010, setting out proposals to address these disparities by:

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

- ***Consolidation***

7.4 This Order consolidates the earlier instruments on this subject, as described above, as well as making further modifications to the application of Part II of the Insolvency Act 1986.

8. Consultation outcome

8.1 The consultation closed on 25 June 2010. 16 responses were received from a cross-section of stakeholders. The respondents broadly supported all proposals, in particular those that sought to modify the regime such that administrators would be:

- obliged to provide assistance to the FSCS, enabling the FSCS to pay compensation for both life and non-life contracts and to secure continuity of long-term insurance;
- required to carry on the long term insurance business with a view to its transfer; and
- permitted to enter into new contracts of long-term insurance in certain circumstances

8.2 The majority of respondents, although seeing the benefits of applying the valuation rules under the Insurers (Winding-Up) Rules 2001 to the administration regime for insurers in some circumstances, preferred the administrator to maintain the flexibility of using a range of methods to value contracts insurance. The Government has therefore concluded not to impose a duty on administrators to apply the valuation rules under the Insurers (Winding-Up) Rules 2001. The Government considers that as, while the approach to valuation provided for in the 2001 Rules may be suitable in some cases, it would be more beneficial for policyholders, as well as other creditors of an insurer, for an administrator to retain the power to determine which methodology to use to value insurance contracts when making a distribution.

8.3 The majority of respondents also considered that a duty should not be placed on the administrator to assist the FSCS in securing continuity of non-life insurance contracts. The Government considers that in most circumstances, the termination of non-life insurance contracts is likely to be less detrimental to the policyholder due to the short term nature of non-life contracts and the relative ease in which alternative comparable cover could be found. The Government has therefore concluded not to place a duty on the administrator to assist the FSCS to secure continuity of non-life insurance contracts -

9. Guidance

9.1 No guidance shall be issued for these legislative changes.

10. Impact

10.1 The impact on business, charities or voluntary bodies, if their turnover is less than £1m, should be beneficial as these bodies would be considered to be protected policyholders under the eligibility criteria of the scheme rules. They would therefore

benefit from continued protection and received benefits as they fall due, should their insurer face financial difficulties.

10.2 The impact on the public sector is negligible.

10.3 An Impact Assessment is attached to this memorandum.

11. Regulating small business

11.1 The legislation applies to small business. The Government, evaluating the proposals against the Small Firms impact assessment guidelines, considers that this order will not have any significant impact on small firms because the legislation is already in existence and simply replaces a power by a duty.

12. Monitoring & review

12.1 The outcome of the legislative changes will be subject to an internal review after 2 years and the legislation may be amended accordingly.

13. Contact

Phelan Hill at the Treasury Tel: 020-7270 6105 or email: phelan.hill@hmtreasury.gsi.gov.uk can answer any queries regarding the instrument.