Enhancing the insolvency tools for insurance companies

Financial Services and Markets Bill – schedules 12 and 13

In July 2022, as part of a wider set of reforms to the existing Financial Services and Markets Act 2000 (**FSMA 2000**), the government proposed two key changes to the existing insolvency arrangements in respect of insurance companies. These involve enhancement of the court's existing power under section 377 of FSMA 2000 and a ban on the operation of termination provisions (or so-called *ipso facto* clauses) for certain contracts. The two changes are set out in schedules 12 and 13 of Financial Services and Markets Bill (**FSMB**).

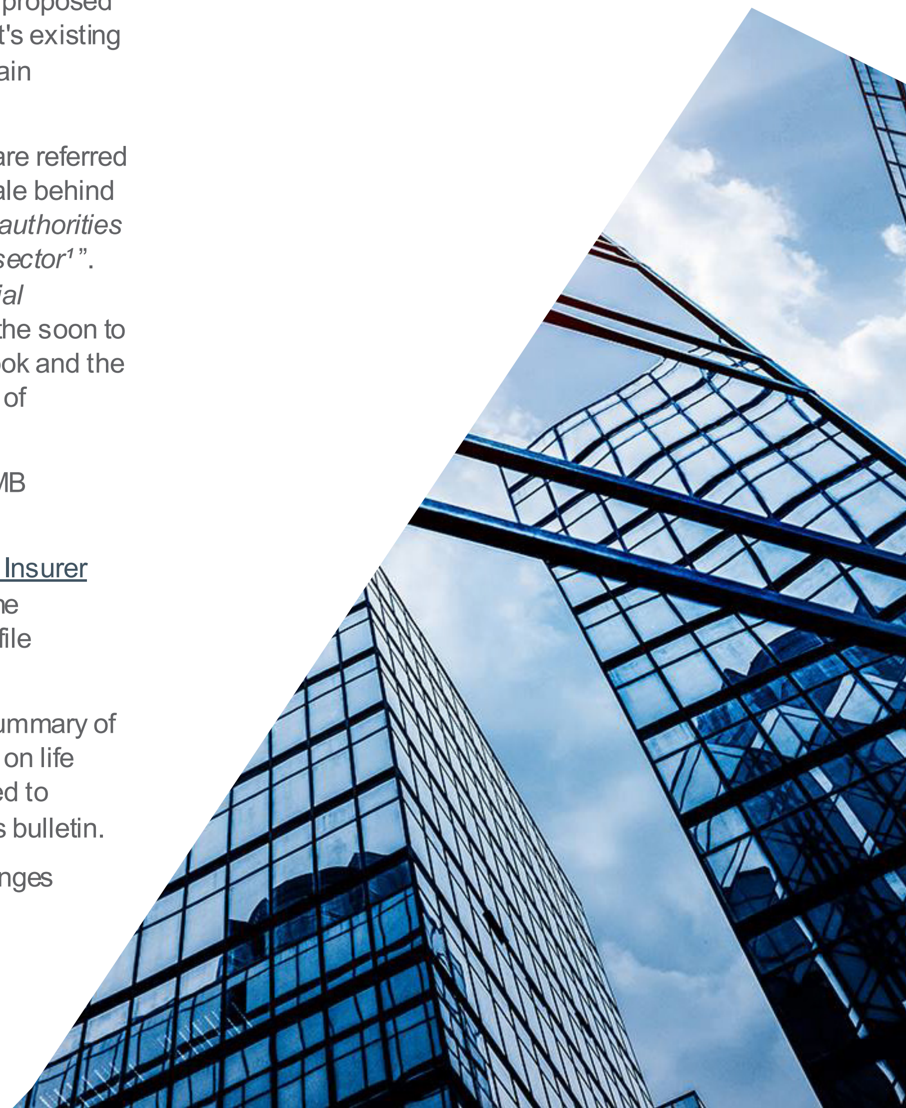
The changes were anticipated in the May 2021 consultation entitled "*Amendments to the Insolvency Arrangements for Insurers*" and are referred to in the response document titled "*Amendments to the Insolvency Arrangements for Insurers: Response to Consultation*". The rationale behind these amendments is to promote the continuity of cover for insurance policyholders "*by allowing earlier intervention by the regulatory authorities when an insurer was suffering financial distress, reduce costs to industry, and help maintain public confidence in the UK's insurance sector*[1]". Separately, in February 2023, the Bank of England published a Consultation Paper entitled "*CP3/23 – 'Dealing with insurers in financial difficulties'* setting out, amongst other things, the PRA's approach in relation to the consent and related processes in connection with the soon to be amended section 377 of FSMA 2000 and the proposed changes to be made to the Policyholder Protection Part of the PRA Rulebook and the Financial Services and Compensation Scheme (**FSCS**) Statement of Policy as a result of the changes set out in schedules 12 and 13 of the FSMB.

At the time of writing, the FSMB is currently going through the committee stage in the House of Lords. It is not yet clear when the FSMB (including schedules 12 and 13) will come into force.

In addition to the changes proposed in the FSMB, on 26 January 2023, HM Treasury published a consultation entitled "Introducing an Insurer Resolution Regime". This proposes the introduction of a resolution regime for insurance companies (the **IRR**) which broadly follows the resolution regime for banks under the Banking Act 2009 but with some differences to reflect the different capital structure and risk profile of insurers.

Finally, we note that the government has now concluded its review of Solvency II – the prudential regulation regime for insurers. Its summary of the responses to its consultation can be found here. The proposed reforms (which are wide-ranging and will have a significant impact on life insurers' regulatory balance sheets) seek to ensure that the UK's prudential regulatory regime for the insurance sector is better tailored to support the unique features of the UK sector and the UK regulatory approach. The Solvency II reforms are not dealt with further in this bulletin.

Below we provide a high-level summary of the existing insolvency arrangements in respect of insurers and a summary of the key changes proposed, both to the insolvency tools as set out in the FSMB and in relation to the IRR. We have also prepared a more detailed Q&A analysis for each of the changes, which can be accessed by clicking "**Read more**" in the relevant section.



[1]See "Consultation Description" at https://www.gov.uk/government/consultations/amendments-to-the-insolvency-arrangements-for-insurers-consultation

The existing insolvency regime for UK insurers

Generally speaking, the insolvency procedures and rules available in England[2] in respect of a UK-regulated insurance company are the same as those available to any other company[3] in England. There are however certain modifications in terms of (amongst other things) the length of an administration, the priority of claims in a liquidation, additional consent required before commencing a winding up, disapplication of the Part A1 moratorium under the Insolvency Act 1986 (the **IA 1986**) and the prohibition on ipso facto clauses.

In practice, financially distressed, UK-regulated insurance companies usually end up utilising a scheme of arrangement under sections 895-901 of the Companies Act 2006 to deal with their insurance liabilities prior to being dissolved or liquidated. These schemes may be proposed by either the directors of an insurance company or an insolvency officeholder such as an administrator or liquidator.

For insurance companies with short-tail liabilities, insurance companies will tend to rely on "cut-off" (or estimation) schemes whereby all claims are valued and the assets of the insurance company distributed amongst creditors in so far as possible in one single dividend, as soon as practicable after the scheme becomes effective[4].

For insurance companies with significant long-tail business, these entities will tend to rely on "reserving" (or "run-off" schemes). These are schemes under which the business of the company is run off over a number of years (i.e. no new business is taken on) but scheme administrators fix, at regular intervals, the dividend payment which may be made to creditors with established claims, having regard to the assets of the company available for that purpose and the need to reserve for creditors whose claims may mature in the future. The dividend payment is usually determined by an actuarial calculation based on the assets of the insurance company and the likely level of future claims which are yet to be incurred and/or notified. In this way, creditors with established claims do not have to wait until the end of the scheme to receive some payment in respect of their claim[5].

There are also "reserving" schemes of arrangement that provide for a "cut-off" mechanic should the scheme creditors decide that it would be more beneficial to bring a "reserving" scheme to an end rather than waiting for all long-tail claims to crystallise.

Administration, the main reorganisation proceeding under the IA 1986, was not available in respect of UK insurance companies until 31 May 2002[6]. Prior to this date, UK insurance companies would often be placed into provisional liquidation in order to obtain protection from creditors while proposing a scheme of arrangement. Since the administration procedure was made available, it has been used a few times[7] but it is still rare for an insurance company to be subject to an insolvency process.

One of the key differences between the insolvency regime for a "normal" UK company and that for a UK insurance company is the statutory priority that is given to policyholder claims. Furthermore if the insurance company is a so-called "composite" (carrying on long-term insurance business and general insurance business), there are rules[8] that provide for the separate application of long-term and general business assets in a liquidation to the payment of preferential debts and direct insurance liabilities.

[2] All references in this note to England include England and Wales.
[3] Other than insurers organised as a Friendly Society
[4] The scheme of arrangement concerning The Hawk Insurance Company Limited is an example of a "cut-off" scheme of arrangement.
[5] The scheme of arrangement concerning BAI (Run-off) Limited (In Scheme of Arrangement) is an example of a "reserving" scheme of arrangement.
[6] Article 3 of the Financial Services and Markets Act 2000 (Administration Orders relating to Insurers) Order 2002 (SI 2002/1242).
[7] An example is the administration of AA Mutual International Insurance Co Limited in 2004 after changes to the administration regime were brought in by the Enterprise Act 2002.
[8] Insurers (Reorganisation and Winding Up) Regulations 2004.

Write-down powers

Schedule 12 of FSMB seeks to provide insurers (and the various stakeholders who deal with them) with more clarity as to when and how the existing power under section 377 of FSMA 2000 to reduce (or "write down") the amount of an insurer's liabilities can be exercised to deal with an insurance company that is in financial distress. In essence, subject to being satisfied that certain conditions have been met, the courts are able to reduce certain liabilities of an insurer and appoint an individual (or a group of individuals) to oversee the write-down process.

We would note, in particular, the following provisions of schedule 12 which may require more thought by clients and counterparties:

- There is a carve-out for secured liabilities but not those secured by a floating charge[9]. This will put a lot of emphasis on the legal characterisation of the security which, in the case of security over receivables or fluctuating pools of assets, can be a nuanced question.
- It appears that the write-down order is not intended to impact on "outward" reinsurance agreements constituting potential assets of the distressed insurer. Although HM Treasury points out that the same is true of an insolvency process (i.e. outward insurance would not be affected by such process), the insurance liabilities would not be written down in such a process (albeit that they are unlikely to be paid in full). In the context of a write-down, this could mean that the insurer is able to collect in more than it actually owes following the write-down order. The write-down order may cease to have effect, and the original liabilities reinstated, upon the occurrence of certain events (such as a liquidation of the insurer). Schedule 12 deals with the consequences of the contingent or prospective reinstatement for certain insolvency purposes (such as the test of insolvency under section 123 of the Insolvency Act 1986) but not for all purposes (such as the test for wrongful trading). Furthermore, there are express provisions in relation to the written down amount carrying statutory interest but it is not clear what contractual interest will accrue on the written-down liabilities.

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[9] In paragraph 15 of the "Draft Statement of Policy – Dealing with insurers in financial difficulties" as appended to "CP3/23 – 'Dealing with insurers in financial difficulties'", the PRA notes that, in practice, the write-down would only apply to a floating charge contractually subordinated to rank alongside the policyholders of an insurer (such as those granted to inward reinsurance creditors).

Ban on ipso facto clauses and restrictions on policyholder surrender rights

Schedule 13 of the FMSB seeks to prevent counterparties of insurance companies under certain types of contracts from terminating or exercising any right to terminate due to an insurer entering into "financial difficulties" as defined in schedule 13. The concern this seeks to address is that a counterparty may seek to hold an insurer to ransom in relation to the supply of critical goods or services by insisting that its outstanding debts are paid, or that it is offered better terms, as a condition to continuing to provide those goods or services while the insurer is in an insolvency process. Under the provisions in schedule 13, the counterparty will be required to continue to perform the relevant contract on the same terms, and will not be guaranteed payment of arrears, provided that the insurer continues to pay the counterparty during the relevant insolvency process.

These provisions are similar to the ones that were introduced for "normal" companies by the Corporate Governance and Insolvency Act 2020 (**CIGA**). The key difference, however, is that the CIGA provisions excluded financial contracts so as not to impact on the cost of borrowing whereas, while there are limited carve-outs in schedule 13, many financial contracts will be caught.

Unlike the Banking Act 2009 (which switches off certain events of default or contractual termination rights that would otherwise be triggered by a resolution measure), the provisions in schedule 13 go further and prevent a counterparty from relying on any contractual termination right (including for non-payment or fraud) that may have arisen prior to the commencement of the relevant insolvency process if that right has not been exercised prior to the commencement of such process (the "snooze you lose" provisions). It remains to be seen whether these provisions will encourage counterparties to terminate (rather than granting waivers or indulgencies, to a distressed insurer) so as to ensure that any termination right is exercised prior to the commencement of the relevant insolvency process.

Although there are protections for set-off and netting (which will clearly be of great interest and relief to derivative counterparties dealing with insurers) and for financial collateral arrangements, these protections are much more limited in scope than those contained in the CIGA regime.

Finally, there are also measures that aim to restrict the exercise of surrender rights by policyholders, subject also to certain carve-outs.

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Changes to the Financial Services and Compensation Scheme (FSCS)

Schedule 12 of The FSMB authorises the scheme manager of the FSCS to introduce changes to the rules as currently set out in the Policyholder Protection Part of the PRA Rulebook. The changes to be introduced will primarily be aimed at ensuring that a policyholder will not be in a worse position as a result of the imposition of a write-down order when compared to a policyholder's position if an insurer enters into an insolvency proceeding. The scheme manager is also authorised by the FSMB to put in place provisions that would allow for the recovery of any assistance provided as part of the FSCS in the event of a write-down order being imposed.

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How the FSMB could affect you

Clearly the provisions of schedules 12 and 13 will have the most impact on a distressed insurer. However, the provisions will also need to be dealt with as part of the legal diligence for counterparties dealing with insurance companies (and in legal opinions, if relevant). In each case, such counterparties may want to ask themselves the following key questions:

– Could my debt be written down pursuant to a write-down order?

– Will I be able to terminate or accelerate my contract notwithstanding the ipso facto provisions?

– Will the moratorium which might be imposed in conjunction with the write-down order prevent me from enforcing my debt (and related security)?

In particular, the following types of counterparties might want to take note of the following provisions of schedules 12 and 13:

Those lending to (or investing in) insurance companies

– The question of whether such debt could be subject to a write-down order will depend on the type of debt. A capital markets instrument (or bond) is eligible to be written down (unless such debt is secured by a fixed charge or the subject of title transfer collateral) but a loan is likely to be a contract involving financial services which is excluded. This is a change to the current position where all debt (including loans and bonds) could, in theory, be written down under section 377 FSMA 2000.

– Lenders and bondholders/bond trustees may be prevented from accelerating the debt or bonds upon a write-down order being made or upon an administration of the insurer. This is a change to the existing position. Although such lenders/bondholders will still be able to accelerate for non-payment (or on various other grounds), such a right will need to be exercised prior to the write-down order or administration (although a lender/bondholder will still be able to accelerate for any non-payment post the write-down order or administration).

– Furthermore, a lender/bondholder will be prevented from enforcing its debt (or any related security, other than a financial collateral arrangement) during the period in which any write-down order is in effect if a moratorium is imposed; this is similar to the moratorium that would currently apply if the insurance company were to go into administration.

Those entering into derivative transactions with an insurance company

– The close-out amount under a derivatives contract will not be capable of being written down as it will fall under the exclusion for a contract involving financial services. This is an improvement on the current position where, in theory, amounts due under derivative contracts could be written down under section 377 FSMA 2000.

– The question of whether such a counterparty can close out upon a write-down order or administration is more complex. Derivative transactions are within the definition of financial contracts to which the ban on contractual termination will apply but there is a carve-out for protected set-off and netting arrangements within the meaning of section 48P of the Banking Act 2009 (as well as for financial collateral arrangements). Given that the close-out of the transaction is an essential part of any set-off or netting, we consider that a derivatives counterparty would be able to close out for the purposes of exercising set-off or netting rights but not for any other purpose.

– Furthermore, a derivatives counterparty will be prevented from enforcing its debt (or any related security, other than a financial collateral arrangement) during the period in which any write-down order is in effect if a moratorium is imposed; this is similar to the moratorium that would currently apply if the insurance company were to go into administration.

How the FSMB could affect you (*cont.*)

Reinsurance counterparties (including those based overseas)

- Where the insurance company has liabilities under a reinsurance contract, those liabilities are capable of being written down unless secured by a fixed charge (or the subject of title transfer collateral).
- For *counterparties who reinsure UK insurers* (including UK branches of non-UK insurers), the impact of the write-down provisions will depend upon whether (i) an exposure to the UK insurer exists (most likely an issue for reinsurance contracts structured as swaps) and (ii) whether that exposure is secured by a fixed charge (or the subject of title transfer collateral). Recoveries under reinsurance contracts (where the insurer has the benefit of such contracts) will not be affected by the insurance liabilities being written down (i.e. the "pay-as-paid" doctrine is disapplied). This will mean that the insurer will be able to recover, under the reinsurance contract, more than it owes pursuant to the write-down order. It is possible that any excess assets would be dealt with if and when the write-down order ceases to apply.
- It is not clear how the FSMB would affect non-English law governed reinsurance agreements. From a practical perspective, the government is of the view that non-UK law governed reinsurance contracts should be re-papered to take into account the statutory amendment being effected, via the FSMB, though this is not proposed to be a regulatory requirement.
- Reinsurance contracts will also be caught by the prohibition on termination rights in the event of a write-down order or administration, but many reinsurers will be accustomed to transacting on the basis that termination rights for cedant insolvency are unavailable anyway. These reinsurers should note, however, that although a reinsurance counterparty will still be able to terminate for non-payment (or on various other grounds), such a right will need to be exercised prior to the write-down order or administration (although a reinsurance counterparty will still be able to accelerate for any non-payment post the write-down order or administration).
- For *insurers who cede to UK reinsurers* (including UK branches of non-UK insurers), the write-down provisions are likely to be important and put into focus (i) the robustness of ostensible fixed charges (and title transfer collateral arrangements) and (ii) termination rights which arise before the prohibition on termination rights in the event of a write-down order or administration affects those rights.

Insurer Resolution Regime

As referred to above, HM Treasury is consulting separately on the possible introduction of an IRR and this is not part of the FSMB. The IRR broadly follows the resolution regime for banks under the Banking Act 2009 but with some differences to reflect the different capital structure and risk profile of insurers. It is anticipated that it would only be used for larger insurers where there was a threat to UK financial stability as a result of the potential failure of such insurer. The IRR is based on the "Key Attributes of Effective Resolution Regimes for Financial Institutions" produced by the Financial Stability Board and so the regime should broadly align with what is being proposed for insurers on a global basis.

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Write-down powers

1. What is being proposed?	The courts will be able to reduce (“**write down**”) the liabilities owed by an insolvent (or soon to be insolvent) insurance company under its insurance contracts[10] on such terms as may be determined by the court itself. This is to ensure that insurance companies that are currently in financial trouble are able to exit the market in an orderly manner via a solvent run-off.
2. Does it only apply to UK incorporated insurance companies?	The provisions will apply to UK incorporated insurance companies and (in theory at any rate) foreign firms with a UK authorisation in respect of a UK branch. However, this is subject to the PRA consenting to the application. If there is any doubt as to whether the statutory provisions would be recognised and effective in the jurisdiction where a foreign firm is incorporated, this may mean that the PRA would not consent to the application.
3. Isn't this an existing power of the courts under section 377 of FSMA 2000?	As currently drafted, section 377 of FSMA 2000 provides a high-level power for the courts to exercise its write-down powers. However, as this power has never been used[11] and is drafted in broad terms, there is much uncertainty about the scope, range of applicants and reach of the courts' powers under section 377 of FSMA 2000. As such, the government, via the changes set out in the FSMB, is looking to clarify and enhance the court's current powers vis a vis section 377 of FSMA 2000.
4. Who will be able to apply?	The following parties are able to apply to the court for a write-down order: – HM Treasury (the **Treasury**); – the Prudential Regulation Authority (the **PRA**); – an insurance company; – a shareholder of the relevant insurance company; or – a policyholder or other creditor (including, a contingent or prospective creditor) of the relevant insurance company, with the condition that any applicant who is not the PRA or the Treasury will need consent from the PRA[12] before lodging an application. In addition, there is a duty on the part of the PRA to consult with the Financial Conduct Authority (**FCA**) before making any application or providing its consent to an application.

[10] More generally, as drafted in the FSMB, the scope of the court's write-down powers is limited primarily by reference to “excluded liabilities”, which includes a range of liabilities ranging from secured liabilities (other than liabilities secured by a floating charge), financial liabilities or liabilities with a maturity of less than 7 days. In other words, the write-down powers is applicable to a wide range of liabilities incurred by an insurer but it is understood that the main liabilities being targeted would be liabilities of an insurer under an insurance policy, especially in relation to retail life insurance policies. The full list of “excluded liability” is detailed “here”.

[11] See section 2.4 of the “Amendments to the Insolvency Arrangements for Insurers: Consultation”.

[12] See the “Draft Statement of Policy – Dealing with insurers in financial difficulties” as appended to “CP3/23 – ‘Dealing with insurers in financial difficulties’” for the list of considerations that the PRA will take into account as part of its consent process.

5. What are the requirements that the court will need to be satisfied before approving/delivering a write-down order?	Before approving/delivering a write-down order, the courts will need to be satisfied that: – the insurer is, or is likely to become, unable to pay its debts; and – making the order is reasonably likely to lead to a better outcome for the insurer's policyholders and other creditors (taken as a whole) than not making the order
6. What is the effect of a write-down order on the liabilities being written-down and rights being limited or suspended?	For as long as a write-down order has effect, the liabilities and rights of a creditor whose liabilities and rights are the subject of a write-down order will be "deferred" until the write-down order ceases to have effect. Following the cessation of a write-down order, the "deferred" rights and liabilities will be "reactivated". From a balance sheet perspective, it is expected that the deferred portion of the relevant liabilities will be kept off the insurer's balance sheet[13] for so long as those liabilities are being deferred.
7. What is the effect of a write-down order on the reinsurance contracts of the insurers?	The FSMB includes a section which has the effect of statutorily amending the "pay-as-paid" doctrine as set out in various UK-law governed reinsurance contracts. In essence, the recoveries under the aforementioned reinsurance contracts should not be affected by the insurance liabilities being written down. In other words, for the purposes of recovering under the reinsurance contracts, the liabilities should be treated as not being reduced or written down. This will have the effect that the insurer will be able to recover, under the reinsurance contract, more than it currently owes pursuant to the write-down order. It is not clear how such excess assets will be dealt with although we refer to questions 16 and 17 below about the write-down order ceasing to apply. From a practical perspective, the government is of the view that non-UK law governed reinsurance contracts should be re-papered to take into account the statutory amendment being effected, via the FSMB, on UK law governed reinsurance contracts, though this is not proposed to be a regulatory requirement.
8. What is the effect of the imposition of a write-down order on the day-to-day business of an insurer?	Following the imposition of a write-down order, there is a general prohibition on the affected insurer from: – disposing or dealing with assets other than in the ordinary course of business or with the consent of the PRA; – paying variable remuneration not regulated by a collective bargaining agreement other than with the consent of the PRA; and – making a distribution other than with the consent of the PRA
9. Is a moratorium being imposed when a write-down order is in effect?	Yes but with an exception to any enforcement action being taken with the permission of the court. A moratorium may be imposed: – during the write-down application period[14] ; – during the period when the write-down order is in effect; or – during any such period as may be ordered by the court

[13] See section B.38 of the "Amendments to the Insolvency Arrangements for Insurers: Consultation"
[14] In essence, from the date on which a write-down application is made and ending on the date on which an order is either made, withdrawn or dismissed.

Question	Answer
10. Who will be responsible for overseeing the whole process (implementation and execution) once a write-down order has been granted?	An individual (known as the **Write-Down Manager**) or a group of individuals (known as the **Write-Down Managers**[15]), who will be an officer of the court, will be responsible for monitoring the relevant insurance company's affairs. Whilst monitoring the affairs of the relevant insurance company, the write-down manager will need to form a view as to whether: – the write-down order is still reasonably likely to lead to a better outcome for the insurance company's creditors as a whole (including the policyholders whose policies have been written down); or – the directors of a relevant insurance company will need to take certain action or refrain from taking certain actions in order for the write-down order to lead to a better outcome for the insurance company's creditors as a whole. As part of the write-down manager's role, the write-down manager must also, if so directed, provide a report on such matters relating to the insurance company's affairs at such interval as the FCA and/or PRA may so direct.
11. Who is qualified to act as a Write-Down Manager?	Paragraphs 20 and 21 of the "Draft Statement of Policy – Dealing with insurers in financial difficulties" as appended to "CP3/23 – 'Dealing with insurers in financial difficulties'" set outs the PRA's expectation with regards to the qualifications of a Write-Down Manager. In the event of a dearth of suitable candidates, the government has proposed that the PRA be able to propose a member of its staff as a candidate of last resort[16] .
12. Who will bear the cost and expenses of the Write-Down Manager?	Although the FSMB does not explicitly state who is to bear all the related cost and expenses of the Write-Down Manager, the government expects that the remuneration and fee schedule of a Write-Down Manager (including that of a "nominee" (which is further discussed below at 13) will be recoverable from the relevant insurer[17]. The expected remuneration and fee schedule will include costs of hiring experts to assist the Write-Down Manager and any expenses relating to applications/petitions put to court. The costs and remuneration relating to the Write-Down Manager will be reviewed and approved by the court. Lastly, if a Write-Down Manager's costs and expenses were to still be outstanding once a write-down has been terminated, those outstanding sums will be treated as claims of an unsecured creditor[18].
13. Who is a "nominee" Write-Down Manager and how is that "nominee" different from a Write-Down Manager appointed by the court?	A "nominee" Write-Down Manager is essentially a Write-Down Manager yet to be appointed by the court. This individual will be nominated by one of the eligible applicants seeking a write-down. It is this "nominee" Write-Down Manager who will be responsible for developing the substantial proposals of any proposed write-down. In practice, unless the PRA deems the "nominee" Write-Down Manager either "not suitably qualified" and/or the "nominee" Write-Down Manager declines to continue to act as the Write-Down Manager, it is anticipated that the "nominee" Write-Down Manager will be the eventual Write-Down Manager appointed by the court.

[16] See section 3.40 of the "Amendments to the Insolvency Arrangements for Insurers: Response to Consultation" and paragraph 22 of the "Draft Statement of Policy – Dealing with insurers in financial difficulties "as appended to "CP3/23 – 'Dealing with insurers in financial difficulties'".
[17] See section B.93 of the "Amendments to the Insolvency Arrangements for Insurers: Consultation".
[18] See section 3.46 of the "Amendments to the Insolvency Arrangements for Insurers: Response to Consultation".

14. What powers have been granted to the Write-Down Manager as part of their duty to monitor the affairs of the insurance company?	The general principle and approach as set out in the various consultation papers and the FSMB is to set out the minimum powers of the Write-Down Manager in the FSMB, and for such minimum powers to be varied or supplemented by the necessary court order approving the write-down and guidance to be provided by the PRA in due course. The Write-Down Manager's powers can be categorised into two broad categories, namely: (i) powers that can only be exercised by applying to the court; and (ii) powers that can be exercised without applying to court. Powers that fall under the former category include: – seeking directions from the court in relation to carrying out of the Write-Down Manager's functions; – varying or terminating a write-down order as the Write-Down Manager thinks likely to achieve the best outcome for the policyholders and the other creditors (taken as a whole); and – varying or amending the scope of (a) the ban on ipso facto clauses; (b) the ban on the exercise of "switching rights" for life insurance policyholders; and (c) the surrender limit for life insurance policyholders. Powers that fall under the latter category include: – obtaining information and assistance from certain group of persons, including directors, employees, service providers of the insurer or a member of the insurers group of companies. This power is enforceable by way of an injunction; and – consenting to a policyholder exceeding the surrender limit imposed by the FSMB.
15. What are the safeguards against the Write-Down Manager's decisions?	The following two groups of stakeholders are able to challenge, via an application to court, any act, omission or decision of a Write-Down Manager for separate reasons: – regulators and insolvency office-holders, if any act, omission or decision is not in the interest of the insurer's policyholders and other creditors (taken as a whole); and – individuals directly affected by the effect of a write-down order, if any act, omission or decision has unfairly harmed the interests of the relevant individual. The first category includes the FCA, the PRA, the scheme manager of the FSCS and a provisional liquidator of the insurer. The second category includes a director, shareholder, policyholder or other creditor of the insurer, in addition to any other person affected by the write-down order. In terms of the remedies available, the court has a wide discretion and is able to make any such order as the court thinks appropriate except ordering the Write-Down Manager to pay any compensation.
16. How long will a write-down order have effect?	A write-down order will take effect either on (i) the date set out in the write-down order or (ii) the date on which a Write-Down Manager has been appointed, whichever is later. A write-down order will cease to have effect either (i) on the end/termination date set out in the write-down order or (ii) upon the occurrence of a "termination event" set out in the FSMB, which includes, amongst others, the onset of a liquidation or administration, a write-down order being revoked or the transfer of the written-down policies pursuant to an insurance business transfer scheme.

17. What happens when the write-down order ceases to have effect?	It appears that the relevant liabilities that have been "written down" will revert to their original amounts. The FSMB deals with the consequences of such "springing" liability for certain purposes (such as the test for inability to pay debts under section 123 of the Insolvency Act 1986) but not for all purposes. Furthermore, although the FSMB expressly states that the written-down liabilities will carry statutory interest until the amounts are paid, it is not clear what will happen to any contractual interest that would have accrued on such liabilities while they were written down.

Ban on ipso facto clauses and restrictions on policyholder surrender rights

1. What is being proposed?	As part of the plan to avoid any potential destabilisation of an insurer's recovery/insolvency process, there will be, in addition to an imposition of a 5% surrender limit on certain insurance contracts (see discussion below), a general prohibition on the termination of: a) certain contracts for the supply of goods and services; b) financial contracts (as detailed "here"); and c) reinsurance contracts, by a counterparty of an insurance company, in respect of that contract, by reason of the insurer entering into "Financial Difficulties". "Financial Difficulties" include: – an insurer being subject to a write-down order; – an insurer being in administration; and – a winding-up petition being presented in relation to an insurer where the winding-up petition has not been withdrawn or determined.
2. Can I still terminate on non-insolvency grounds (e.g. for non-payment)?	Yes if the default occurs after the insurer has entered into "Financial Difficulties" but see below where the default occurs prior to the onset of "Financial Difficulties" (the so-called "snooze you lose" provisions).
3. Can I terminate on the basis of a default that occurred prior to the insolvency procedure?	If the counterparty had a right to terminate the contract or supply before the insurer entered into "Financial Difficulties" but did not exercise that right, the counterparty may not terminate for that reason during the period of "Financial Difficulties"(the so-called "snooze you lose" provision). Therefore, if a counterparty does not exercise its rights in relation to a pre-"Financial Difficulty" default, it will temporarily lose that right following the onset of a "Financial Difficulty". The drafting is very broad and would suspend any contractual right to terminate that arose pre-"Financial Difficulty" including, for example, a right to terminate for fraud or wilful default. In that situation, a counterparty would require the insurer or office-holder (which excludes the Write-Down Manager) to consent, or a hardship order to be obtained from the court (see below) before it could terminate the contract.

4. How can I terminate my supply contract?	Where the prohibitions on termination are in effect, the counterparty may only terminate the contract if: a) the relevant office-holder (i.e. the administrator, or provisional liquidator) consents to the termination; b) the insurer consents to the termination if there is no relevant office-holder; or c) the court is satisfied that: – the continuation of the contract would cause the counterparty hardship; – termination of the contract would lead to a better outcome for the insurer's policyholders and other creditors (taken as a whole), in the scenario where the insurer is in "Financial Difficulty" by virtue of being subject to a write-down order; or – termination of the contract would make it reasonably likely to promote the purpose of administration, in the scenario where the insurer is in "Financial Difficulty" by virtue of being in administration, and grants permission for the termination of the contract.
5. Should I continue to perform pursuant to the contract? What if it is clear the company no longer requires the benefits that accrue from the performance of the contract?	Where the counterparty cannot terminate, the FSMB seems to oblige it to carry on performing pursuant to the contract even before the office-holder (or insurer) has confirmed whether it wants the performance. We suspect that, in practice, the counterparty would speak to the office-holder/insurer to make sure that the performances are needed/wanted.
6. Are there any exceptions to the obligation to continue to supply?	Yes. If a counterparty considers that the obligation to continue to perform is causing the counterparty hardship then they will be able to apply to court for permission for the termination of the contract. Prior to applying to court, the applicant must either (i) consult the PRA, if the applicant is the FCA, the administrator, a provisional liquidator or a Write-Down Manager or (ii) seek the PRA's consent if the applicant does not fall into the aforementioned category.
7. What does "hardship" mean?	The FSMB does not include a definition of 'hardship' and we are not aware of any case law regarding the meaning of the same expression used in respect of the ipso facto provisions in CIGA. Without further guidance, the court will need to develop principles to determine what factors to apply when determining whether the continuation of supply is causing the supplier hardship.
8. Will I get paid for continued performance? What protection will I have?	Although the insurer is not required to pay for any arrears prior to the commencement of the relevant "Financial Difficulty", the insurer ought to make payments for the continued performance that it is receiving post the relevant "Financial Difficulty". Furthermore, where the relevant "Financial Difficulty" is administration, the office-holder should ensure that these amounts are paid as expenses of the administration (i.e. ranking ahead of pre-insolvency unsecured and floating charge claims). If the insurer ceases to make such payments post the relevant "Financial Difficulty", the counterparty will be able to terminate

9. Will I get paid for pre-“financial difficulty” debts?	A counterparty is prohibited from making it a condition of any future supply of goods and services that any pre-“Financial Difficulty” outstanding arrears are paid. Although the insurer may choose to pay the counterparty, there is no obligation to do so. Furthermore, as detailed above, where the insurer enters into “Financial Difficulty”, prior termination rights are temporarily suspended.
10. Do the ipso facto provisions apply to all types of entities?	Under CIGA, there are exclusions for certain counterparty types, largely financial institutions. Under schedule 13 there are no such exclusions although see below as to what contracts are excluded.
11. Do the ipso facto provisions apply to all types of contracts?	Only a “relevant contract” (as detailed “here”) will be subject to the ban. However, this definition is very wide and will include most types of financial contract. In practice, there are only exclusions for: – protected set-off and netting arrangements within the meaning of section 48P of the Banking Act 2009; – financial collateral arrangements; and – certain financial markets arrangements under Part 7 of the Companies Act 1989 or the financial settlements legislation
12. Do the surrender limits apply to all types of contracts?	Only a “relevant contract of insurance” (as detailed “here”) will be subject to the imposition of a surrender limit

Changes to the Financial Services and Compensation Scheme (FSCS)

1. Will the imposition of a write-down order trigger the protections afforded to a policyholder under the current rules set out in the Policyholder Protection Part of the PRA Rulebook?	As things currently stand, the imposition of a write-down order will not trigger the protections[19] afforded to a policyholder under the FSCS scheme as set out in the Policyholder Protection Part of the PRA Rulebook (the **FSCS Protections**). As currently set out in Chapter 10.4 of the Policyholder Protection Part of the PRA Rulebook, the FSCS Protections will only be triggered if certain "default events" occurs and a write-down order is not included in the list of "default events". As such, policyholders stand to lose out in the following two scenarios if a write-down order is imposed: – A write-down order is imposed and in effect. At the same time, the claim of a policyholder becomes due and payable and no "default event" has occurred. – A write-down order is imposed and in effect. At the same time, the claim of a policyholder becomes due and payable after the occurrence of a "default event". In scenario one, as no "default event" has occurred, the policyholder will not benefit from any of the FSCS Protections. The insurer would only be obliged to pay out the lower, post-write-down amount of a claim. In scenario two, the FSCS Protections would only extend to the lower post-write-down amount of a claim given that this written-down amount represents the liability owed by the insurer to the policyholder during the time which the relevant "default event" has occurred.
2. What has been proposed by the FSMB in order to deal with the two scenarios mentioned above?	The FSMB essentially authorises the scheme manager, being the entity established by the FCA under FSMA 2000, to put in place: – "provision requiring the scheme manager to take specified measures for safeguarding policyholders affected by write-down orders" that would essentially "enable payments to be made to affected policyholders in respect of the reduced value of their entitlements (or contingent entitlements)"; and – "provisions giving the scheme manager a right of recovery in respect of the financial assistance provided" without the right of recovery "being exercised against a policyholder of an insurer"

[19] The protections afforded under the FSCS range from 100% of the value of an insurance claim to 90% of the value of an insurance claim, depending on the type of insurance contract involved.

3. The authorisation and remit provided to the scheme manager under the FSMB seems rather broad. What does this mean in practice?	Although we will ultimately need to refer to the updated rules as set out in the Policyholder Protection Part of the PRA Rulebook, the Government's intention is to ensure that no policyholder is worse off as a result of the imposition of a write-down order when compared to the policyholder's situation when an insurer has entered into a formal insolvency process[20] .
	In practice, we would expect the FSCS Protections to deal with the abovementioned scenarios in the following manner:
	– In Scenario 1, whilst the insurer would be responsible for paying the lower post-write down value of a claim, there would be a "top-up" payment made by the FSCS to make up for any shortfall between the lower post-write down value of a claim and the original value of the claim, subject to any compensation limits imposed by the FSCS. The FSCS will pay the compensation amounts directly to the insurer, subject to those amounts being ring-fenced, for further distribution to the policyholder. The PRA proposes that the FSCS's payment obligations will be triggered when:
	  – a write-down order has been made;
	  – a Write-Down Manager has been appointed;
	  – a bank account has been opened in the name of the relevant insurer; and
	  – a trust deed[21] has been entered into in connection with the abovementioned bank account; and
	– In Scenario 2, the FSCS Protections will be for the original claim value rather than for the lower post-write-down value.
	In terms of recoveries by the FSCS, in practice, we would expect the FSCS to initiate recoveries in the following manner:
	– In Scenario 1, any future recoveries will accrue to the FSCS in the event there is a subsequent write-up of a claim back to the original claim value. If the recoveries received by the FSCS is more than the "top-up" payment made, any additional recoveries will need to be paid to the policyholder; and
	– In Scenario 2, the FSCS's recoveries will follow the approach proposed by the Bank of England in its February 2023 Consultation Paper entitled "CP3/23 – 'Dealing with insurers in financial difficulties'"[22]

[20] See section B.169 of the "Amendments to the Insolvency Arrangements for Insurers: Consultation".
[21] See page 7 of the appendix to " CP3/23 – 'Dealing with insurers in financial difficulties" consultation for the minimum criteria required for the trust deed. '
[22] See page 9 of the appendix to " CP3/23 – 'Dealing with insurers in financial difficulties" consultation for the FSCS's right of recovery.

Exclusions and Relevant Contracts

What is an "excluded liability"?	An "excluded liability" is: a) a liability with an original maturity of less than 7 days; b) an amount payable in respect of goods delivered, or a service provided, on or after the date on which the write-down order is made; c) an amount in respect of remuneration or expenses of a person appointed under section 377G to act as the manager of the write-down order (including amounts incurred before, as well as after, the person's appointment in connection with the order or the application for the order); d) an amount secured on property of any kind, other than an amount secured by a charge which, as created, was a floating charge; e) an amount payable in respect of wages or salary arising under a contract of employment; f) a contribution or other sum payable in respect of an occupational pension scheme; g) an amount payable in respect of redundancy payments; h) an amount payable under a contract or other instrument involving financial services. For this purpose: – "contract or other instrument involving financial services" has the meaning given by schedule ZA2 to the IA 1986, but does not include an agreement which is, or forms part of, an arrangement involving the issue of a capital market investment (see paragraph 6 of that schedule); – "floating charge" has the meaning given by section 251 of the IA 1986 or paragraph (1) of article 5 of the Insolvency (Northern Ireland) Order 1989; – "redundancy payment" means: a) a redundancy payment under part 11 of the Employment Rights Act 1996 or part 12 of the Employment Rights (Northern Ireland) Order 1996 (S.I. 1996/1919 (N.I. 16)), or b) a payment made to a person who agrees to the termination of their employment in circumstances where they would have been entitled to a redundancy payment under that Part if dismissed; – "wages or salary" includes: a) a sum payable in respect of a period of holiday; b) a sum payable in respect of a period of absence through illness or other good cause; c) a sum payable in lieu of holiday.

What is a “relevant contract of insurance”?	A contract of long-term insurance **which is not** a contract in respect of which the following conditions are met: a) the benefits under the contract are payable only on death or in respect of incapacity due to injury, sickness or infirmity; b) the contract has no surrender value, or the consideration consists of a single premium and the surrender value does not exceed that premium; c) the contract makes no provision for its conversion or extension in a manner which would result in it ceasing to comply with either of the above conditions.
What is a “relevant contract”?	A “relevant contract” is: a) a contract for the supply of goods or services to the insurer, b) a financial contract, or c) a reinsurance contract under which contracts of insurance the insurer carries out as principal are reinsured.
What is a “financial contract”?	A “financial contract” is: a) a contract for the provision of financial services consisting of: – lending (including the factoring and financing of commercial transactions), – financial leasing, or – providing guarantees or commitments; b) a securities contract, including: – a contract for the purchase, sale or loan of a security or group or index of securities; – an option on a security or group or index of securities; – a repurchase or reverse repurchase transaction on any such security, group or index; c) a commodities contract, including: – a contract for the purchase, sale or loan of a commodity or group or index of commodities for future delivery; – an option on a commodity or group or index of commodities; – a repurchase or reverse repurchase transaction on any such commodity, group or index; d) a futures or forwards contract, including a contract (other than a commodities contract) for the purchase, sale or transfer of a commodity or property of any other description, service, right or interest for a specified price at a future date;

What is a "financial contract"? (continued)	e) a swap agreement, including: – a swap or option relating to interest rates, spot or other foreign exchange agreements, currency, an equity index or equity, a debt index or debt, commodity indexes or commodities, weather, emissions or inflation; – a total return, credit spread or credit swap; – any agreement or transaction similar to an agreement that is referred to in sub-bullet point 1 and 2 above and is the subject of recurrent dealing in the swaps or derivatives markets. However, a master agreement for any contract or agreement referred to in this section is not a "relevant contract" for the purposes of the ban on ipso facto provisions.
Are there any exclusions?	Schedule 13 (the ipso facto provisions) does not affect the operation of: a) Part 7 of the Companies Act 1989 (financial markets and insolvency); b) the Financial Markets and Insolvency Regulations 1996; c) The Financial Markets and Insolvency (Settlement Finality) Regulations 1999; d) the Financial Collateral Arrangements (No 2) Regulations 2003. Furthermore, nothing in schedule 13 affects any "protected arrangements" within the meaning of section 48P of the Banking Act 2009 which includes certain security interests, title transfer collateral arrangements, set-off arrangements and netting arrangements.

Insurer Resolution Regime

1. What is the timing for these provisions?	This is still at the very early stages as the closing date for responses to the consultation is not until April 2023. We suspect it is unlikely that legislation will be enacted until 2024.
2. Is this a domestic or international initiative and how similar is this regime likely to be to anything introduced globally?	The IRR is based on the core elements that the Financial Stability Board[23] considers to be necessary for an effective resolution regime, as set out in the Key Attributes of Effective Resolution Regimes for Financial Institutions. We would therefore expect the IRR to be broadly in keeping with what is being proposed for insurance companies more globally. Furthermore, the IRR broadly follows the resolution regime for banks under the Banking Act 2009 but with some differences to reflect the different capital structure and risk profile of insurers. The Banking Act 2009 was based largely on the European Bank Recovery and Resolution Directive. Whilst the UK is no longer bound by EU legislation, we would expect the IRR to be broadly similar to any resolution regime proposed for European insurance companies in response to Solvency II.
3. What are the resolution objectives?	The proposed objectives of the IRR are: – **Objective 1**: to protect and enhance the stability of the financial system of the UK, including in particular by: (a) preventing contagion; and (b) protecting the ability of those who are or may become insurance policyholders to access critical functions, including the continuity of services on existing policies; – **Objective 2**: to protect and enhance public confidence in the stability of the financial system of the UK; – **Objective 3**: to protect public funds, including by minimising reliance on extraordinary public financial support; – **Objective 4**: to protect policyholders of the firm in resolution, including those covered by an insurance guarantee scheme; and – **Objective 5**: to avoid interfering with property rights in contravention of a Convention Right (within the meaning of the Human Rights Act 1998).
4. What are the conditions that would need to be met before the IRR could be used?	The government proposes four resolution conditions that would need to be met in order for an insurer to be placed into resolution; this would ensure that a high bar would need to be met to justify the exercise of the resolution powers. The proposed resolution conditions are as follows: – the PRA assesses that an insurer is failing or likely to fail; – the Bank of England (as resolution authority) assesses that, having regard to timing and other relevant circumstances, it is not reasonably likely that (ignoring the stabilisation powers) action will be taken by or in respect of the insurer that will result in the first condition ceasing to be met; – the Bank of England (as resolution authority) assesses that the exercise of the stabilisation powers is necessary having regard to the public interest in the advancement of one or more of the statutory resolution objectives; and – the Bank of England (as resolution authority) assesses that one or more of the statutory resolution objectives would not be met to the same extent if stabilisation powers were not deployed.

[23] The Financial Stability Board is an international body that monitors and makes recommendations about the global financial system. It was established after the G20 London summit in April 2009 as a successor to the Financial Stability Forum.

5. What stabilisation options are being proposed?	The stabilisation options being proposed are as follows: 1. **Transfer to a private sector purchaser**: the Bank of England (as resolution authority) would be able to transfer the shares or all or part of the business of the failing insurer to a private sector purchaser. The transfer would be done by statutory instrument and would not require a court order. Any such transfer would override any right of veto by third parties and would "switch off" certain events of default that might otherwise be triggered by the transfer. There would however be certain safeguards as to which see below. 2. **Transfer to a bridge institution**: the Bank of England (as resolution authority) would be able to transfer the shares or all or part of the business of the failing insurer to a bridge institution as a temporary measure. This is intended to "buy time" for due diligence and valuation. Where the business is transferred to a bridge institution, that institution would require the relevant Part 4A FSMA permissions and be subject to supervision from the PRA and the FCA. 3. **Bail-in**: the Bank of England (as resolution authority) would be able to propose the write down of an insurer's liabilities including policyholder liabilities (or the conversation of such liabilities into equity or other ownership interests in the insurer) in a manner that respects the hierarchy of claims in a liquidation. The aim of the bail-in is that losses should be allocated to a firm's shareholders and subordinated debt holders before liabilities to other creditors are written down. Where FSCS-protected policyholders are written down, the intention would be that the FSCS will provide "top-up payments", to be held on trust to pay such policyholders. 4. **Temporary public ownership**: as a procedure of last report, the government proposes that the failing insurer could be placed into temporary public ownership. In addition to the four stabilisation options, the proposed regime would also include the following tools that could be used in combination with the stabilisation options: – **Balance sheet management vehicle**: this would allow the transfer of all or part of the business of the failing insurer to a special purpose vehicle which would act as a warehouse for the relevant assets and liabilities with a view to maximising their value through either an eventual sale or orderly wind down. – **Insurer administration procedure**: not to be confused with administration under the Insolvency Act 1986, this procedure would be equivalent to the bank administration procedure under Part 3 of the Banking Act 2009. It would be used where part of the business is left behind with the original insurer to ensure that the insurer (acting by its special administrator) provides support to the bridge insurer or private sector purchaser in relation to any critical services left behind with the original insurer.

6.	Will there be any safeguards?	Although these are not set out in any detail in the consultation, it appears that there will be similar safeguards to those found in the Banking Act 2009 including: – certain restrictions on partial property transfers to ensure that a partial property transfer does not create implications for set off and netting provisions (and associated opinions); – "No creditor worse off" (**NCWO**) safeguard to ensure that creditors have a right to compensation where they do not receive at a minimum what they would have received in a liquidation. The proposed regime would allow HM Treasury to appoint an independent valuer to determine the level of NCWO compensation.
7.	Will insurance companies need to prepare Resolvability Assessments and Resolution Plans in the same way as banks currently do?	The Key Attributes framework provides for: – regular "Resolvability Assessments" which would determine and address barriers to resolution; and – ongoing Recovery and Resolution Planning for, at a minimum, systemically important insurers. The PRA already works with insurance firms to develop recovery and resolution plans and (in some cases) resolvability assessments. The government intends to build on this work in ensuring that the requirements in the Key Attributes framework are met. The government expects that insurance firms may need to carry out some additional work to support the creation of Resolution Plans because they would relate to the use of the new powers that the PRA does not currently possess (and therefore does not factor into its work).

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