HM Treasury

Amendments to the Insolvency Arrangements for Insurers:

Response to Consultation

April 2022

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This publication is available at: www.gov.uk/official-documents.

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ISBN: 978-1-911686-70-5

PU: 3196

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Chapter 1
Introduction

1.1 In May 2021, HM Treasury published the consultation document 'Amendments to the Insolvency Arrangements for Insurers'. The consultation document sought views on proposals to amend the current insolvency arrangements for insurers, to enable the UK authorities to better manage insurers in financial distress.

1.2 The government consulted on five specific proposals:

I) Expanding and clarifying the court's existing power under section 377 of the Financial Services and Markets Act 2000 ('FSMA') to order a reduction ('write-down') of the value of an insurer's contracts;

II) The creation of a new position of a 'write-down manager' – an officer of the court appointed to support a write-down under section 377 FSMA (as amended by Proposal One);

III) The introduction of a moratorium on certain contractual termination rights in both service contracts and financial contracts held with insurers upon application to the court for, and during (in the case of (a) and (b)): (a) an administration; (b) a write-down under section 377 FSMA (as amended by Proposal One); or (c) a winding up;

IV) For life insurance policies only: the introduction of a stay (suspension) on policyholder surrender rights upon application to the court for, and during (in the case of (a) and (b)): (a) an administration; (b) a write-down under section 377 FSMA (as amended by Proposal One); or (c) a winding up; and

V) A change to the operation of the Financial Services Compensation Scheme ('FSCS') in the event of a write-down under section 377 FSMA (as amended by Proposal One) to ensure protected policyholders are not financially worse off under such a write-down.

1.3 The consultation ran from 20 May to 13 August 2021, during which time the government received 9 written responses (see Annex A for a list of respondents). This document summarises the responses received to the consultation and sets out the government's response to the issues raised.

Amendments to the Insolvency Arrangements for Insurers

1.4 The UK insurance sector is robustly supervised, well-capitalised and resilient to shocks, and benefits from the requirements of a rigorous and risk-based prudential regulatory system. Nevertheless, insurers may still experience unexpected financial difficulties and, in rare cases, become insolvent. The failure of an insurer could have negative impacts on policyholders and the wider economy. For example, businesses may be unable to operate, and consumers could be affected - particularly through the loss of long-term insurance arrangements, compulsory insurance policies (such as motor insurance) or the loss of life insurance policies which can provide a main source of income for some policyholders.

1.5 It is important that the UK regulatory authorities have the requisite tools to manage the failure of an insurer in an orderly way and, in doing so, provide protection to policyholders. As such, the government has put forward proposals to pre-emptively amend the current insolvency arrangements for insurers. This will ensure they remain effective, up-to-date and consistent with best practice.

1.6 With the exception of proposal IV, above, which will only apply to life insurers, these proposals will apply to all insurers with a Part 4A permission to effect or carry out contracts of insurance as principal. However, the association of underwriters known as Lloyd's of London would not be in scope. This is because separate legislation provides for the specific restructuring and winding-up procedures available to Lloyd's of London[1].

1.7 Taken together, the objective of these proposals is to enhance and provide clarity on existing powers for managing insurer distress, to:

- Promote continuity of cover by allowing earlier intervention by the regulatory authorities (including before – and in order to avoid – an insurer becoming insolvent) to maintain an insurer's solvency sufficiently to allow a solvent run-off and orderly exit from the market. This would allow policyholders to continue to receive payment for claims promptly, albeit with reductions in some instances (although FSCS coverage may be available), while the insurer continues operating.

- Protect policyholders by promoting continuity of cover and by empowering the Prudential Regulation Authority (PRA) to amend its rules to provide appropriate safeguards for FSCS-protected policyholders in the event of a court-ordered write-down under section 377 FSMA.

- Reduce costs to industry by unlocking additional loss absorbency through an expanded court-ordered write-down procedure, and by reducing the extent of value reduction in the subsequent insolvency of a distressed insurer. Otherwise, the greater the size of losses, the more compensation the FSCS may need to provide, and the greater the costs passed on to industry via the FSCS levy.

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[1] Please refer to the Insurers (Reorganisation and Winding Up) (Lloyd's) Regulations 2005 (SI 2005/1998).

- Maintain public confidence in the UK insurance sector by enhancing the tools available to manage insurer distress in an orderly way. As some of the current powers are untested and only set out at a high level, an insurer entering into insolvency could be a prolonged and disruptive process which could adversely affect policyholders and undermine public confidence.

1.8 It is the government's intention to achieve the above objectives while providing appropriate safeguards and protections, and balancing the interests of different stakeholders.

Chapter 2
Summary of Responses

2.1 The government received 9 written responses to the consultation. The consultation asked 24 questions, divided into 6 sets. The responses to these questions are summarised below.

2.2 The first set of questions were general questions, covering the entire set of proposals.

General Questions

Question 1: In what circumstances do you envisage these proposals would be used?

2.3 Seven respondents answered this question. The majority of respondents focused on the proposed amendments to the write-down power contained in section 377 FSMA. Four respondents noted that the amended write-down power is most likely to be used in relation to life insurers (rather than general insurers). A minority of respondents also referenced the write-down power being most appropriate for direct insurers (as compared to reinsurers) with large numbers of individual policyholders.

2.4 Two respondents stated that a write-down is more likely to be an attractive option where an insurer's financial deterioration is identified at an early stage.

Question 2: Do you envisage any impediments to the use of the proposed measures in practice?

2.5 Seven respondents answered this question. Again, respondents focused on the proposed amendments to section 377 FSMA when answering this question. Respondents referenced a range of potential impediments, including that:

- A successful write-down will require confidence in an insurer's existing management, given that managers and directors will remain in control of an insurer undergoing a write-down (contrary to the situation in insolvency proceedings, where control of the firm would be taken over by an insolvency practitioner).
- A lack of precedent of use of the section 377 FSMA write-down power could lead insurers to prefer more established insolvency or restructuring procedures.

- An insurer's directors may be concerned about their potential legal liability for continuing to trade while insolvent and may therefore opt to enter formal insolvency proceedings[1] (such as administration) rather than applying for a write-down.

- A write-down ordered by courts in the UK may not be recognised internationally, so may not affect liabilities relating to contracts governed under non-UK law.

Question 3: Do you agree that these proposals would usefully add to the flexibility with which the distress of an insurer could be managed?

2.6 Seven respondents answered this question. The majority of respondents agreed that these proposals would usefully expand the toolkit for managing insurers in financial distress, although a minority also noted that these benefits may be limited to the types of scenarios described in responses to question 1, above.

2.7 One respondent disagreed, stating that the impediments to use of the proposals would outweigh any benefits or increased flexibility.

Question 4: Do you have any other comments on these proposals or the current insolvency arrangements for insurers?

2.8 Six respondents provided further comments, including in relation to:

- Whether the treatment of shareholders under the proposed amendments to the section 377 FSMA write-down procedure is fair and appropriate;

- Whether an insurer being in run-off (i.e. no longer writing new insurance business) will be a precondition for use of the amended write-down procedure;

- Why the government is proposing to make these changes ahead of proposals for a specific resolution regime for insurers, aligned with international standards, on which HM Treasury is actively engaging with the Bank of England;

- Whether statutory interest will be payable on liabilities which are written down, then subsequently 'written up'[2] and paid to creditors; and

- Whether HM Treasury has engaged with the PRA and Financial Conduct Authority (FCA) on these proposals, and whether the PRA will publish guidance on how it is likely to assess requests for consent to write-down applications.

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[1] Company directors may be liable for wrongful trading (see sections 214 and 246ZB Insolvency Act 1986) if they delay entry into formal insolvency proceedings and continue to trade in the knowledge that the company is insolvent.

[2] The government is proposing that a 'write-up' would fully or partially reverse a reduction (write-down) in one of more of an insurer's liabilities, following the process described in paragraphs B.39 – B.41 of the government's consultation paper (available here: https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/987949/Amendments_to_the_Insolvency_Arrangements_for_Insurers.pdf)

Questions on Proposal One

Question 5: How will the proposed amendments to section 377 FSMA enhance the UK authorities' ability to manage the distress of an insurer, resulting in a better outcome for policyholders and creditors?

2.9 Seven respondents answered this question. The majority of respondents expressed views that the proposed amended write-down procedure will provide a useful restructuring option, with potential for reduced overall costs and disruption compared to other procedures, and for potentially improved continuity of cover for policyholders.

2.10 One respondent disagreed, noting concerns that the proposed amendments would not provide benefits due to the perceived impediments.

Question 6: To what extent do you believe that the proposed amendments to section 377 FSMA will improve the usability of the write-down procedure?

2.11 Eight respondents answered this question. Several respondents noted that the proposed amendments would increase clarity, certainty and availability of information relating to the write-down procedure, and should therefore make it more usable in future.

2.12 One respondent noted that by explicitly providing for the possibility of a future 'write-up' (a full or partial reversal of a write-down), these proposals ensure that any future improvement in an insurer's financial position can benefit creditors. This change should make the procedure more attractive and encourage its use. This respondent also noted that providing for the appointment of a write-down manager creates a beneficial supportive framework around the procedure.

2.13 One respondent expressed a view that the power is still unlikely to be used following these amendments given lack of precedent. Other respondents noted that, while they broadly support the proposal, insurers may continue to opt for tried and tested procedures.

Question 7: Do you believe the tests which the court would need to be satisfied are met in order to sanction a write-down under section 377 FSMA (as amended by this proposal) are sufficient to safeguard against undue impact of a write-down on an insurer's creditors (including its policyholders)?

2.14 Seven respondents answered this question. The majority of respondents agreed that the proposed tests[3] are logical and would sufficiently protect the interests of creditors.

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3 As set out in the government's consultation paper, and under these proposed amendments, the test which the court would have to be satisfied is met before a write-down could be ordered would be: (1) that the insurer 'is, or is likely to become, unable to pay its debts'; and (2) that the write-down is reasonably likely to lead to a better outcome for creditors as a whole compared with the counterfactual of the next most likely scenario if the court were not to sanction the write-down. For more details, see paragraph B.11 of the government's consultation paper, available here:

2.15 Some respondents noted that aligning part of the proposed test with the test for entry into administration[4] would provide familiarity, and help potential applicants to understand how the court is likely to interpret this part of the test. Similarly, respondents noted that the element of the test comparing against the most likely scenario, were the court not to sanction the write-down, has precedent in other restructuring procedures, and should be widely understood. One respondent expressed concerns as to how 'reasonably likely to lead to a better outcome' and 'creditors as a whole' might be interpreted; however, several respondents noted familiarity with this approach.

2.16 One respondent noted concerns about the practicalities of gathering the necessary evidence to meet the court test.

2.17 One respondent queried whether the information provided to creditors around the write-down would be targeted at an appropriate level, including to ensure that information provided to policyholders is not overly technical.

2.18 In assessing whether the proposed test sufficiently safeguards the interests of creditors, respondents also queried:

- Whether floating charge holders would be excluded from the scope of the write-down, or whether this would be restricted to fixed charge holders;
- Which financial contract liabilities would be out of scope of the write-down; and
- Whether it will be specified in legislation that, when considering a write-down, the court would need to take into account the order of priority which would apply on winding-up[5].

Question 8: Do you support the nominee write-down manager being able to provide independent views to the court (including on the impact of the write-down on an insurer's creditors (including its policyholders)) at a write-down court hearing?

2.19 Seven respondents answered this question. Most respondents agreed that the nominee write-down manager's input would be beneficial at the court hearing to sanction a write-down, provided the nominee is suitably qualified and independent. Respondents noted that this approach is consistent with the role of office-holders in other procedures, such as the monitor role in the moratorium procedure introduced by the Corporate Insolvency and Governance Act 2020.

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https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/987949/Amendments_to_the_Insolvency_Arrangements_for_Insurers.pdf.

4 Section 11 of Schedule B1 to the Insolvency Act 1986 sets out that the court can make an administration order only if satisfied that the company 'is, or is likely to become, unable to pay its debts'. Schedule B1 is applied (with modifications) to insurers by The Financial Services and Markets Act 2000 (Administration Orders Relating to Insurers) Order 2010 (SI 2010/3023). Available here: https://www.legislation.gov.uk/uksi/2010/3023/contents/made

5 The order of priority on winding-up is set for insurers by The Insurers (Reorganisation and Winding Up) Regulations 2004 (SI 2001/353) (in particular regulation 21) available here: https://www.legislation.gov.uk/uksi/2004/353/contents.

2.20 One respondent questioned whether the term 'independent views' needs to be more clearly defined, in order to avoid potential disputes.

Question 9: Would the proposed amendments to section 377 FSMA be likely to impact an insurer's costs (including in relation to debt issuance)?

2.21 Six respondents answered this question. Respondents set out that the proposed amendments could impact insurers' costs to some extent in the following areas:

- Debt issuance: two respondents noted that the proposals could increase the cost of debt financing for insurers, due to a perception that lenders are more likely to bear losses in the event that an insurer enters financial difficulties;
- Reinsurance pricing: one respondent raised the possibility that the proposal to clarify that any write-down of liabilities would not affect recoveries under any outwards reinsurance (i.e. to create a statutory variation of the 'pay-as-paid' doctrine)[6], could lead to an increase in the pricing of reinsurance arrangements;
- Adapting IT systems: one respondent raised potential costs related to adapting an insurer's IT systems to ensure that they can manage payment of claims at a reduced percentage; and
- Updates and notification: two respondents noted that the proposals may require insurers to update their legal documentation, including policy terms and conditions, and to notify policyholders of these changes.

Question 10: To what extent would the proposed moratorium on legal process during a write-down under section 377 FSMA assist in the write-down process?

2.22 Seven respondents answered this question. There was general agreement amongst respondents that a moratorium on legal process is critical to the usability of the write-down power, given that equivalent protections are available during insolvency procedures.

2.23 A minority of respondents expressed concern about the impact of the proposal on creditor rights, given that, currently, this type of moratorium typically only applies while an insolvency practitioner is in control of a company. One respondent questioned whether the moratorium could be in place for several years, given the potential length of a write-down procedure.

2.24 One respondent asked for further clarity as to which types of legal action would be prevented, and in particular whether it would be possible to apply to have the insurer placed into an insolvency procedure during the write-down process.

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[6] The government's proposals regarding the treatment of reinsurance liabilities are set out in paragraphs B.46 – B.48 of the consultation paper, available here: https://www.gov.uk/government/consultations/amendments-to-the-insolvency-arrangements-for-insurers-consultation.

2.25 One respondent noted that if the moratorium did not prevent secured creditors exercising security, this could leave the write-down vulnerable to destabilisation.

Question 11: Do you have any other comments on Proposal One?

2.26 Seven respondents answered this question. Several questions were raised by individual respondents. These related to:

- The lack of creditor involvement in the write-down court process compared to other restructuring procedures. However, the same respondent noted that this is likely appropriate, given that administering creditor involvement in the write-down procedure would be highly complex in practice;
- The appropriateness of a provisional liquidator not being able to apply for a write-down under the proposals;
- The risk of wrongful trading liability for an insurer's directors while a write-down plan is being designed, and whether this could disincentivise use of the write-down procedure;
- The potential lack of international recognition of the write-down procedure, and whether this could be problematic; and
- One respondent's view that the proposal to require reinsurers to pay out claims at their full value following a write-down is a significant departure from the status quo, and risks increasing reinsurance costs.

Questions on Proposal Two

Question 12: Do you support the introduction of a write-down manager to support a write-down under section 377 FSMA (as amended by Proposal One)?

2.27 Seven respondents answered this question. All these respondents supported the creation of the position of write-down manager, provided that they are suitably qualified, and that the specifics of their role are clearly defined. Two respondents noted that the creation of this position is consistent with comparable roles in other restructuring procedures.

Question 13: To what extent do you agree with the proposed eligibility criteria for a write-down manager under Proposal Two?

2.28 Seven respondents answered this question. Respondents expressed general support for restructuring and/or insurance experience being the key criteria for a candidate write-down manager, though some suggested that this should be set in legislation rather than left to the discretion of the court. One respondent questioned whether restructuring experience (as well as insurance industry experience) should be a formal requirement.

2.29 One respondent noted that a write-down manager's appointment should be publicised at Companies House (where appropriate), and via the regulator's search engine.

2.30 One respondent noted that a write-down manager may need to appoint advisors or external experts for support, given the complexity of their role.

Question 14: Do you think the proposed role and powers of the write-down manager would be adequate to ensure the development/ implementation of a write-down is in the interests of the insurer and its creditors (in particular policyholders)?

2.31 Seven respondents answered this question. Respondents generally agreed that the write-down manager's role and powers are adequate. However, some concern was expressed that their powers would not be sufficiently robust if an insurer's directors were not willing to cooperate fully with the appointee.

2.32 A number of specific questions were raised in relation to the write-down manager's role, including:

- Whether a write-down manager would be required to constantly monitor an insurer's financial position and the management of its business;
- How long a write-down manager would be expected to spend in the role;
- What a write-down manager's exact status would be in relation to the insurer;
- Who would approve the terms, including fees, on which a write-down manager is engaged, and where a write-down manager fees would sit in the creditor hierarchy;
- Whether there would be a limit on the additional advice a write-down manager could obtain; and
- Whether a write-down manager would be eligible to take on a subsequent administrator or liquidator appointment.

2.33 Two respondents also asked about the extent of a write-down manager's personal liability, and whether they would require 'directors' and officers' insurance or some form of indemnification (possibly including an indemnity out of the insurer's assets).

Question 15: Do you have any other comments on Proposal Two?

2.34 Six respondents put forward various comments and questions, detailed below:

- Several respondents questioned whether legislation would specify the frequency with which a write-down manager would need to issue reports.
- One respondent commented that a provisional liquidator should be able to challenge a write-down manager's decisions, and to petition the court for their removal.
- One respondent noted that there should be clear guidelines as to when discretionary aspects of the write-down manager role, such as the proposed

power to allow exemptions to the stay on life insurance policyholder surrender rights, can be exercised.

- One response suggested that insurance expertise should be a specific legislative requirement for all write-down manager candidates.

Questions on Proposal Three

Question 16: Do you agree that the proposed moratorium under Proposal Three would help provide stability, leading to better outcomes for policyholders and creditors overall, in the circumstances outlined above?

2.35 Seven respondents answered this question. The majority of respondents agreed that the proposed moratorium would significantly benefit an insurer's stability, and supported the proposal provided that appropriate safeguards are in place for creditors. Most respondents also welcomed the inclusion of a hardship exemption for creditors.

2.36 Two respondents disagreed and expressed concerns that the moratorium could affect counterparties' ability to obtain 'clean' netting opinions for their contracts held with insurers[7], impacting risk management practices and affecting the cost and availability of derivatives for insurers.

2.37 One respondent questioned also whether the proposed moratorium on contractual termination rights is separate to the moratorium on legal process which would apply while an insurer is undergoing a write-down (see paragraphs B.49 – B.57 of the consultation paper).

Question 17: How would the proposed moratorium under Proposal Three affect the terms on which insurers are able to enter into financial contracts and service contracts?

2.38 Seven respondents answered this question. Responses to this question were mixed, with several respondents noting that their answers were speculative. One respondent suggested that a material effect on the terms or pricing of contracts held with insurers is unlikely, given that the proposed moratorium will depend on the insurer continuing to make payments (and meet any other contractual obligations). Furthermore, the moratorium may well be seen by counterparties as preferable to the insurer's insolvency.

2.39 As with the response to the previous question, two respondents were concerned that the proposed moratorium could impact set-off and netting clauses in financial contracts, reducing the ability of counterparties to manage their credit risk in the event of an insurer's insolvency. This in turn could affect counterparties' abilities to obtain clean netting opinions for their contracts held with insurers, leading to increased prices or a reduction in the number of derivative counterparties willing to transact with insurers in scope of this measure.

[7] Netting opinions are legal opinions confirming the enforceability of termination and close-out netting provisions in derivative contracts, need to allow counterparties to account for their financial exposures on a net (rather than a higher, gross) basis.

2.40 One respondent questioned whether the moratorium might be circumvented by amendments to the wording of financial contracts.

Question 18: Factoring in the safeguards outlined above, do you have any concerns about the impact of the proposed moratorium under Proposal Three on the rights of an insurer's counterparties?

2.41 Seven respondents answered this question. The majority of respondents agreed that appropriate safeguards for creditors will be important, and supported the government's proposal that the moratorium should not impact a counterparty's contractual right to terminate for non-payment or other contractual breaches.

2.42 One respondent questioned whether a write-down manager should have a wider power to agree exemptions to the moratorium without the need to apply to the court.

Question 19: Do you have any other comments on Proposal Three?

2.43 Five respondents provided additional comments, detailed below.

- One respondent questioned whether an insurer subject to a write-down would be able to continue to underwrite new business.
- One respondent questioned why the proposed moratorium would terminate where a winding-up order is made, but not where an order for administration is made, noting that it is possible, albeit uncommon, for firms to trade during compulsory liquidation to effect a sale.
- Other respondents reiterated points raised previously (and as set out above) regarding potential adverse impacts on the pricing or availability of derivatives, and regarding the timing of these proposals in relation to the implementation of a specific resolution regime for insurers.

Questions on Proposal Four

Question 20: Do you agree that the proposed stay under Proposal Four would help provide stability, leading to better outcomes for policyholders and creditors overall, in the circumstances outlined above?

2.44 Seven respondents answered this question. Respondents generally agreed that the proposed stay would be a useful protection against a scenario of mass surrenders of life insurance policies, which could effectively constitute a 'run' on an insurer.

2.45 Two respondents noted that some life insurance policyholders will make regular or semi-regular withdrawals (which could be classed as 'partial surrenders') from their policies as a main source of income. Concerns were raised that if the proposed stay operated in a way to prevent these surrenders, which are not motivated by concern for the insurer's financial position, certain policyholders could be left without access to a main source of income.

2.46 One respondent queried whether transfers of life insurance policies from one insurer to another should be captured by the stay, given that such transfers have the same economic effect, from the point of view of the first insurer, as policy surrender.

2.47 One respondent questioned whether thought has been given to the securitisation of surrender rights, and whether such arrangements would be affected by the proposed stay.

Question 21: Factoring in the safeguards outlined above, do you have any concerns about the impact of the proposed stay under Proposal Four on the rights of an insurer's policyholders?

2.48 Six respondents answered this question. The majority of respondents agreed that the impact of the proposed stay on policyholder rights is justified given the benefits of stability for policyholders as a whole, provided the process for hardship applications is transparent and that applications can be processed rapidly.

2.49 One respondent asked whether legislation could provide for an automatic exemption to the stay in the case of a policyholder's severe illness or death.

2.50 One respondent noted that policyholders may be better protected if requirements set on an insurer (such as around notification) included prescribed time limits, rather than requiring action to be taken 'as soon as practicable', as set out in the government's consultation paper[8].

Question 22: Do you have any other comments on Proposal Four?

2.51 Three respondents answered this question, reiterating points made above including around the need for hardship exemptions to be easy to access, and around time limits for complying with requirements set for insurers in relation to the stay.

Questions on Proposal Five

Question 23: To what extent do you agree with government's proposal to ensure protected policyholders are not financially worse off as a result of a write down under section 377 FSMA (as amended by Proposal One), as compared to insolvency?

2.52 Seven respondents answered this question. There was widespread agreement from respondents that the proposed changes to FSCS coverage provide a fair outcome for policyholders whose policies are written down

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[8] See paragraph B.154 in the government's consultation paper, available here: https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/987949/Amendments_to_the_Insolvency_Arrangements_for_Insurers.pdf.

under the amended section 377 FSMA, by creating parity with the insolvency scenario.

2.53 One respondent expressed a view that some guarantee should be extended to non-FSCS-protected policyholders that they will not be left worse-off following a write-down as compared to insolvency.

2.54 One respondent also asked about consideration of overseas policyholders, for whom compensation schemes may or may not be triggered following a section 377 write-down.

Question 24: Do you have any other comments on Proposal Five?

2.55 Two respondents answered this question. Both respondents questioned the government's expectation that FSCS costs will not increase as a result of this proposal, given that compensation will be expanded to a scenario in which it is currently unavailable.

2.56 One respondent also noted that cost-benefit analysis should be carried out given potential for increased costs to industry.

Chapter 3
Government Response

3.1 The government has carefully considered all the responses to the consultation and has engaged with a number of respondents to further discuss certain points. The points below reflect where changes have been made to the government's proposed amendments in order to take account of the points raised and, for certain suggestions, provide an explanation as to why the government decided that no change should be made.

Responses to General Questions

The circumstances in which these proposals would be used

3.2 The government agrees that these proposals, particularly the proposed amendments to section 377 FSMA, are most likely to be used in relation to retail life insurers. A key aim of the package of proposals is to enhance and promote continuity of cover for policyholders, which is typically of greater concern in the life sector[1], where policyholders may find it more difficult to arrange replacement policies on the same terms.

3.3 The government also agrees with respondents that a write-down under an amended section 377 FSMA is more likely to be practicable where financial deterioration is identified at an early stage. It is important to note that the long-term nature of most insurance liabilities (particularly in the life sector) means that solvency issues tend to emerge over time, and sudden or 'fast-burn' insolvency is less common for insurers compared to other financial institutions. As such, the government does not expect this factor to significantly diminish the usability of the amended write-down tool.

Potential impediments to the use of these proposals

3.4 The government recognises that a successful write-down will require confidence in an insurer's existing management. The government anticipates that the PRA will consider any management-related issues when deciding whether to consent to an application for a write-down being put to the court, and would be unlikely to consent where there are concerns around competence or the willingness of management to closely cooperate with the PRA and an appointed write-down manager. Firms undergoing a write-down

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[1] It is for this reason that requirements to carry on contracts of long-term insurance with a view to their transfer to an alternative insurer exist in both administration (see The Financial Services and Markets Act 2000 (Administration Orders Relating to Insurers) Order 2010) and winding-up (see section 376 of the Financial Services and Markets Act 2000).

will remain subject to PRA supervision throughout, and so any governance or risk-management concerns will be addressed through usual supervisory action.

3.5 In response to points raised regarding the lack of precedent for use of the write-down power, the government notes that these proposals are specifically designed to provide greater clarity and certainty around the scope and application of the power. In addition, the government anticipates that the PRA and/or the FCA may consider it appropriate to issue guidance in some areas to ensure lack of familiarity or clarity is not a barrier to use of the amended write-down power. In particular, the government anticipates the PRA will issue guidance on its approach to considering whether to consent to such applications, and to the appointment of write-down managers.

3.6 In response to concerns around potential wrongful trading risk for insurers' directors, the government notes that this risk is already present in the period immediately preceding the implementation of an insolvency or restructuring procedure. For example, directors will already be aware of this risk in the lead-up to applying for administration. As such, this issue is not unique to the proposed amended section 377 write-down power. An insurer in the position to apply for a write-down is also likely to have had its permission to effect new contracts of insurance (under Part 4A FSMA) removed or limited by the PRA. In this situation the firm would not be issuing new contracts and therefore not accruing additional insurance liabilities, which may somewhat mitigate concern over liability for wrongful trading.

3.7 The government does not expect the potential lack of overseas recognition of a write-down to be an impediment in practice. The life insurance sector, where the amended power is most likely to be appropriate, is largely domestically focused. The amended write-down power may not be appropriate for an insurer with a significant book of policies governed by non-UK law, and the PRA may be unlikely to consent to a write-down application in these circumstances.

Increasing the flexibility with which insurer distress can be managed

3.8 The government agrees that the proposals add additional tools to the insolvency/restructuring toolkit available to the UK authorities, which will be beneficial in certain circumstances.

3.9 Importantly, the government recognises that these proposals, particularly the expanded write-down power, will not be appropriate in all cases of insurer distress, and does not intend for this procedure to become the default for any set of firms. Rather, the intention is to provide additional tools which, in certain cases, could provide the best option for an insurer and its creditors.

Other comments on these proposals

3.10 The government recognises potential fairness concerns around the treatment of shareholders during a write-down, and agrees with respondents that shareholders should not continue to profit while an insurer's creditors suffer losses. As such, the government will ensure it is possible to restrict the payment of dividends and other distributions to shareholders (and certain other payments, including staff bonuses) while an insurer is undergoing a write-down. This will ensure that shareholders and other relevant parties do not unfairly benefit at the expense of policyholders or other creditors.

3.11 On the question of whether an insurer will need to be in run-off[2] before applying for a write-down, the government's expectation is that an insurer undergoing a write-down[3] will have engaged the 'ladder of intervention' under Solvency II[4], and is likely to be in breach of its Solvency Capital Requirement (SCR). In the event of a serious breach of SCR, or where an insurer is failing or likely to fail to meet threshold conditions[5], section 55J FSMA permits (but does not require) the PRA to withdraw an insurer's permissions, including the permission to effect new contracts of insurance as principal. As such, the government considers it likely that an insurer undergoing a write-down will have had its effecting permission removed or limited, closing the insurer to new business. However, the government does not intend to make this a statutory condition for use of the write-down procedure, as there may be circumstances in which the PRA determines it inappropriate to withdraw an insurer's effecting permission. This could occur where an effecting permission is deemed necessary to service existing policies (e.g. through automatic renewals or policy additions) and therefore to protect existing policyholders. The government anticipates that the PRA would not permit an insurer undergoing a write-down to continue writing entirely new business, even if for technical reasons the insurer retained its effecting permission.

3.12 In response to questions about the timing of these proposals in relation to the potential introduction of a specific resolution regime for insurers, as set out in the initial consultation document, HM Treasury is actively engaging with the Bank of England to develop a proposal for the introduction of a specific resolution regime for insurers. Any resolution regime would be aligned with internationally agreed standards and best practice, and further details will be set out in due course. However, the government views the introduction of a resolution regime for insurers as a complement to, not a replacement for, these proposals. As such, the introduction of a resolution regime will not reduce the importance of flexible and robust insolvency and restructuring arrangements, which these proposals aim to strengthen.

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2 An insurer is deemed to be in 'run-off' when its 'effecting permission' (i.e. its permission, under Part 4A FSMA, to effect new contracts of insurance as principal) has been limited or removed, and its existing contracts are gradually discharged over time, in accordance with their terms.

3 Note that in order for the court to sanction a write-down, it will need to be satisfied that the insurer 'is, or is likely to become, unable to pay its debts'. This requirement is part of the proposed test the court will need to consider, as set out in paragraph B.11 of the government's consultation paper, available here: https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/987949/Amendments_to_the_Insolvency_Arrangements_for_Insurers.pdf.

4 See the Bank of England's website for more information on the Solvency II Directive: https://www.bankofengland.co.uk/prudential-regulation/key-initiatives/solvency-ii.

5 Threshold conditions are the minimum requirements that firms must meet on an ongoing basis in order to be authorised by the PRA and FCA to carry on regulated financial activities under Part 4A Financial Services and Markets Act 2000.

3.13 The government has considered the question raised by respondents around statutory interest. In response, we are proposing that statutory interest will be payable both:

a) on the written-down portion of any liability which is later written up, provided that, absent the effects of the write-down and/or the proposed moratorium on legal process, the liability would have been due and payable (rather than merely contingent) prior to the write-up; and

b) on any unpaid liability (whether or not subject to the write-down) which would have become due and payable except for the effect of the proposed moratorium on legal process, and in respect of which the creditor was prevented by that moratorium from taking enforcement action.

This means that creditors will receive interest if (and to the extent that) the payment of any part of their claim is effectively delayed by the write-down process or legal process moratorium, providing recompense for this delay, and incentivising insurers to minimise their reliance on these tools. Preferential creditors who are in scope of the write-down (i.e. direct policyholders and, following subrogation of rights, the FSCS) will not be preferential for interest. Statutory interest will accrue for as long as payment is delayed by the write-down process, and will become payable once the write-down is terminated or completed. This sequencing ensures that the payment of interest will not precede the repayment of principal amounts.

3.14 On the query regarding HM Treasury's engagement with the regulators on these proposals, we can confirm that HM Treasury has engaged closely with the relevant authorities (including the Bank of England, PRA, FCA, FSCS, Insolvency Service, and other government departments) during the development of these proposals. Engagement with the regulators has included discussion of what guidance the regulators may consider it appropriate to issue to clarify how aspects of these proposals will work in practice.

Responses to Questions on Proposal One

How the proposed amendments to section 377 FSMA will enhance the UK authorities' ability to manage insurer distress

3.15 The government agrees that the proposed amendments to section 377 FSMA will provide a beneficial alternative procedure for insurers in financial difficulties. As noted above, the government does not view the proposed amended write-down power as a new default for dealing with insurer distress, but expects that in certain circumstances the procedure will offer lower costs, reduced disruption, and beneficial outcomes for firms and policyholders compared to other available procedures.

Whether the proposals will enhance the usability of the write-down power

3.16 The government agrees that the proposed amendments, and particularly the new mechanism to 'write-up' affected liabilities, will enhance the usability of the write-down power.

3.17 We recognise that until the amended write-down procedure is used, there will remain a lack of precedent and experience which could make the procedure more difficult to use initially. However, this is always the case when a procedure is introduced or amended. The government also anticipates that the regulators may consider it appropriate to issue further guidance which should help to navigate these barriers. The government notes that the majority of respondents expressed views that the existing write-down procedure will be significantly more accessible and usable as a result of these proposals, and will provide a useful additional tool.

Whether the proposed court tests sufficiently safeguard the interests of creditors

3.18 The government agrees that the proposed tests safeguard creditor interests, while providing a beneficial degree of similarity to the tests for established procedures. The government notes concerns that certain aspects of the proposed test (including 'reasonably likely to lead to a better outcome' and 'creditors as a whole') may be less familiar, and will be developed through practice. However, respondents noted that the courts have experience considering the rights of various creditor classes in relation to schemes of arrangement and restructuring plans, and that this experience will aid in considering these elements of the proposed test.

3.19 The government has considered the practical difficulties in gathering sufficient evidence to meet the proposed tests, but does not consider that these will be more significant than for other insolvency/restructuring procedures involving an insurer. The PRA (in addition to the FCA) will always have a right to be heard at the court hearing to consider a write-down application, and will be able to provide the court with its views on the proposals and the insurer's financial position. The PRA will also be involved through the consent process.

3.20 The government anticipates that the PRA will issue guidance around the information which should be included in notifications made to creditors following a write-down. It will be for the PRA to consider how this guidance might vary for retail policyholders as compared to more sophisticated institutional creditors. In this context it is also useful to note that an insurer undergoing a write-down will continue to be regulated by the FCA, and to be subject to FCA rules. It is expected that an insurer will need to take account of these obligations when notifying its policyholders, including Principle 7 (Communications with clients) from the FCA Handbook, which states that 'a firm must pay due regard to the information needs of its clients, and communicate information to them in a way which is clear, fair and not misleading.' An insurer undergoing a write-down will continue to be regulated by the FCA, and to be subject to FCA rules.

3.21 The government can clarify that secured creditors will be excluded from the scope of the write-down only where they hold a fixed charge. Where their charge, as created, was a floating charge, they will remain in scope of the write-down. This position recognises the differential treatment of fixed and floating charge-holders in winding-up, and will avoid creating an inappropriate and unintended priority for inward reinsurance creditors, who are often granted a floating charge but contractually subordinated to rank alongside direct policyholders (who have a statutory priority).

3.22 In relation to financial contracts, we can clarify that the financial contracts excluded from the scope of the write-down will be those defined in Schedule ZA2 to the Insolvency Act 1986, although excluding arrangements involving the issue of a capital markets investment (see paragraph 6 of the same Schedule). This definition captures the financial contracts an insurer is likely to hold (including swaps, derivatives, repurchase agreement ('Repo') and securities lending), but not debt issued by the insurer. This exclusion has been tailored to mitigate potential concerns that the pricing or terms on which insurers are able to enter financial contracts could change in recognition of the expanded write-down power if all financial contracts were in scope of the write-down power. However, the exclusion also balances this with the fair treatment of creditors by allowing bonds issued by the insurer to be written down.

3.23 Having further considered the effects of the write-down for contractual counterparties following our review of consultation responses, the government also intends to introduce an exemption ensuring that a write-down order cannot reduce the value of payments due to suppliers for goods or services which are to be provided following the write-down order being made. This exemption is deemed necessary to ensure that the write-down is not used to force suppliers to provide goods or services at a discount on an ongoing basis. Sums owed to suppliers in respect of the period before a write-down order is made ('arrears') will continue to be in scope of the write-down.

3.24 In relation to the court's consideration of the creditor hierarchy, the government's view is that legislation should not explicitly require this consideration. The government expects that the court would naturally have regard to this when considering the relevant alternative to a write-down, given that this alternative will typically be the administration or winding-up of the insurer. Moreover, any write-down plan which did not generally conform with the statutory creditor hierarchy (for creditors in scope of the write-down procedure) would be unlikely to meet the proposed court test, which focuses on creditor outcomes as compared to the counterfactual.

Whether the nominee write-down manager should be able to provide independent views to the court

3.25 The government supports the view that a nominee write-down manager's input will be valuable when considering whether a write-down should be sanctioned, and that this proposal bears similarities to existing procedures.

3.26 The government's view is that the term 'independent views' does not require definition in legislation. However, we anticipate that the PRA will introduce guidance setting out the criteria which would need to be met in order for the PRA to approve an application for the appointment of a write-down manager being put to the court. This guidance may look similar to the relevant qualifications expected of an Independent Expert, as set out in paragraphs 2.16 – 2.20 of the PRA's Statement of Policy on its approach to insurance business transfers[6].

Whether the proposed amendments to section 377 FSMA would impact an insurer's costs

3.27 On the points raised around the cost of debt issuance, the government recognises the importance of this issue. However, it is important to note that, from the perspective of a lender, the additional risk of default as a result of this proposal is minimal to zero. This follows from the fact that a write-down will only be sanctioned where it is deemed preferable for creditors (as a whole) than the alternative, and can only be ordered by a court where the insurer is, or is likely to become, unable to pay its debts (and is thus likely to enter insolvency or restructuring procedures). As such, it is unlikely that the losses incurred by lenders as a result of any write-down would be greater than the losses they would incur if the insurer were to enter an alternative procedure. A useful comparison here is the introduction of the 'bail-in' tool for banks under the UK's Special Resolution Regime. The bail-in tool can impose losses on creditors in a manner comparable to the section 377 write-down power. However, there was no discernible permanent impact on UK bank debt prices when the bail-in tool was introduced in 2013[7]. As such the government expects that any impact on the cost of debt issuance for insurance will be small. However, the government will consider this issue in detail as part of the regulatory impact assessment being undertaken for these proposals.

3.28 In relation to reinsurance pricing, the government's view is that these proposals will not increase the risk of loss faced by reinsurers. The most likely alternative to a write-down under section 377 FSMA would be the insurer entering insolvency procedures, under which reinsurers are currently not able to use 'pay-as-paid' to reduce their liability to the cedant by reference to a reduction in payments to underlying policyholders. As such, replicating this effect following a write-down does not increase the risk of loss for reinsurers, and the government therefore does not expect an increase in reinsurance pricing in recognition of the write-down. The government does not intend to introduce any requirement to 'repaper' reinsurance contracts governed under non-UK law, as was discussed in the consultation paper[8].

3.29 In relation to IT systems, the government is not proposing to require insurers to adapt their systems to facilitate the administration of a write-down or to

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6 https://www.bankofengland.co.uk/-/media/boe/files/prudential-regulation/statement-of-policy/2022/the-pras-approach-to-insurance-business-transfers-sop-jan-2022.pdf?la=en&hash=725D581CFE32B904A38BEA2E069658E62DA2BFB0.

7 See HM Treasury's impact assessment for the EU Bank Recovery and Resolution Directive (BRRD), available here: https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/357688/BRRD_impact_assessment_revised.pdf.

8 See paragraph B.47 of the government's consultation paper, available here: https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/987949/Amendments_to_the_Insolvency_Arrangements_for_Insurers.pdf.

ensure claims can be paid out at a reduced rate. As such, the government recognises that in some cases the write-down procedure will not be practicable due to operational limitations. However, the government considers that any such requirement, applied to all firms, would be disproportionate.

3.30 In relation to documentation and notification, while insurers may need to update policyholders (and potentially their policy documentation) when these proposals come into force, the government expect this can be done using existing communication channels, or as part of regular updates to terms and conditions, and should therefore not result in significant additional costs.

Whether the proposed moratorium on legal process would assist a write-down process

3.31 In response to concerns around the impact of the moratorium on creditor rights, the government has further refined both the scope and time period of the moratorium to ensure it does not go further than required to prevent disruption during a write-down procedure.

3.32 In terms of scope, the moratorium will insulate the insurer from legal action and suspend the right of secured creditors to exercise security. However, exemptions will be created for certain processes, including employment tribunals, claims for awards granted against the insurer by the Financial Ombudsman Service (FOS), and any regulatory actions taken by the FCA or PRA.

3.33 In response to concerns regarding the length of the moratorium, the government will introduce an automatic termination point for the moratorium 6 months after a write-down comes into force. However this period will be subject to court-approved extensions (of up to 6 months in each case). This default time period balances the need for stability, in the interests of an insurer's creditors as a whole, with the rights of individuals to enforce legal claims.

3.34 The government will also introduce additional safeguards as a result of concerns expressed by respondents, including a mechanism for the court to give permission for legal process to proceed where it would otherwise be prevented by the moratorium, and a right for certain parties (including creditors) to apply to the court for an early termination of the moratorium.

3.35 It will remain possible during the moratorium for parties to make petitions or applications to the court for the insurer to be placed into insolvency proceedings. However, entry into administration or winding up requires an insurer to be (or to be likely to become) unable to pay its debts, as defined in section 123 Insolvency Act 1986. Written-down liabilities will be disregarded for the purposes of this test, effectively recapitalising an insurer and protecting it from insolvency procedures unless its financial position continues to deteriorate following a write-down. Absent further deterioration, an insurer which has undergone a write-down is unlikely to meet the test for entry into either administration or winding up. Furthermore, under these proposals, parties will not be able to apply to the court to place an insurer which is subject to a write-down into administration without the consent of the PRA. This additional safeguard minimises the risk that an insurer will be forced into insolvency proceedings while there is still a prospect of the write-down stabilising the insurer.

Other comments on Proposal One

3.36 The government has considered in detail the appropriate level of representation for an insurer's creditors during the write-down process. Given that the majority of creditors will be insurance policyholders, the government's view is that a high level of involvement would be complex to administer, and potentially not in the interests of those creditors, given that it could delay a write-down coming into effect. As such, the government does not intend to introduce a requirement for the court to notify creditors ahead of a write-down hearing, or to create a right for creditors to be heard by the court. While creditors would not be expressly notified, their interests would be protected by the presence of an independent nominee write-down manager. Furthermore, creditors will be able to apply to the court for a variation of a write-down after it is sanctioned, particularly if the insurer's financial position is later found to be better than the assumption on which the initial write-down was based. A write-down manager would also be required to apply to the court for this purpose if they considered it to be reasonably likely to lead to a better outcome for creditors (for example, where an insurer's financial position has improved, allowing for a partial reversal of the write down).

3.37 On the point raised regarding provisional liquidators, the government does not envisage scenarios in which a provisional liquidator would want or need to apply for a write-down under section 377 FSMA. As such, while it will be possible to apply for a write-down while a provisional liquidator is in post, provisional liquidators will not be among the parties eligible to make this type of application.

3.38 The comments made regarding wrongful trading liability, international recognition, and reinsurance, have been responded to above in paragraphs 3.6, 3.7 and 3.28 respectively.

Response to Questions on Proposal Two

On the introduction of a write-down manager position

3.39 The government agrees with respondents that the role and qualifications of a write-down manager will need to be set out in suitable detail, and anticipates that this will be set through a combination of legislation and PRA policy.

3.40 The government agrees with respondents that having a write-down manager in place to monitor a write-down, and provide oversight to the court, is important. As such, the government will ensure that a write-down is not able to proceed without a write-down manager in post. The government expects that the private sector will normally be able to provide a suitable write-down manager candidate without delay. However, to remove the risk that a lack of suitable candidates prevents the use of a write-down, the government is also proposing that the PRA be able to propose a member of its staff as a write-down manager of last resort. A PRA staff member would still need to be appointed by the court in the same way as a private sector appointee, with the same appropriateness tests applied, and the PRA's existing statutory immunity would be extended to expressly apply to such a person.

On the eligibility criteria for a write-down manager

3.41 The government agrees with respondents that insurance and restructuring knowledge will be important to the role of the write-down manager. It will also be a statutory requirement that an appointed write-down manager is fit and proper, free from any conflicts of interest, and is either a licensed insolvency practitioner, a suitably qualified insurance professional, or an actuary. While we recognise concerns related to ensuring that a write-down manager is fit for their role, the government does not view legislation as the appropriate place to define 'suitably qualified insurance professional'. Rather, the government anticipates that the PRA will consider it appropriate to publish guidance on the relevant criteria. It is also important to note that the court will be aware of the PRA's view of a nominee write-down manager's suitability (via the approval process), and this may inform its consideration.

3.42 In response to points raised regarding the publicisation of a write-down manager's appointment, the government proposes to require that a write-down manager, upon taking office, publishes a notice of their appointment in the relevant (i.e. London, Edinburgh or Belfast) Gazette, notifies the registrar of companies, and advertises their appointment in any other manner which they think fit.

3.43 In regard to appointing advisors, as set out in the consultation paper, the write-down manager's statutory powers will include a power to engage appropriate external expertise, as required to facilitate a write-down.

On the proposed role and powers of a write-down manager

3.44 The government has considered concerns expressed by respondents that a write-down manager's default powers may not be sufficiently robust to carry out their role in certain scenarios. While the government does not view it as appropriate to strengthen the default statutory powers of the write-down manager, a statutory requirement on the insurer, its directors, employees and service providers, to provide the write-down manager with reasonable assistance will be introduced. In practice this assistance is likely to include access to relevant (including actuarial, financial and operational) information. This requirement will act similarly to the duty to assist 'skilled persons' set out in section 166(7) FSMA. It is also important to note that the court will be empowered to provide a write-down manager with the powers it considers appropriate at the time of appointment, and that the write-down manager will retain the right to apply to the court to seek directions, for example where their recommendations are disregarded. In response to such an application, the court will be able to make such orders as it sees fit.

3.45 Furthermore, it is important to note that a write-down may not be an appropriate procedure where an insurer's management are unwilling to fully cooperate with a write-down manager, and the PRA would be unlikely to approve an application for write-down being put to the court in these circumstances.

3.46 In response to other specific questions about the role of the write-down manager, the government can clarify that:

- Monitoring an insurer's financial position, and the actions of managers and directors, would be a key part of the write-down manager role. However, the frequency or level of such monitoring will be at the discretion of the write-down manager (or could be detailed in the court order appointing them) rather than set in legislation.

- A write-down manager will remain in post until a write-down is terminated or the insurer is wound up. This means a write-down manager could feasibly be in post for an extended run-off period. However, we expect that the write-down manager's workload would significantly reduce over time. This length of time in office is comparable to that seen for scheme managers under a scheme of arrangement.

- A write-down manager will not be 'in possession' of an insurer in the manner of an administrator or liquidator, and their status in relation to the insurer will be set by their statutory powers and any additional powers bestowed by the court.

- The expected remuneration and fee schedule of a write-down manager would be reviewed and approved by the court as part of the appointment process. While the write-down is ongoing the write-down manager's fees will be treated as expenses of the write-down. If a write-down were to be terminated and any fees were outstanding at this point, they would be treated as sums due to an unsecured creditor.

- There will be no limit in legislation on the amount of external advice which a write-down manager would be able to seek. However, all related expenses would need to be consistent with the fee schedule agreed by the court.

- Where a write-down manager is a licensed insolvency practitioner, and the insurer later enters administration or liquidation, the government does not propose to exclude the write-down manager from taking on a subsequent administrator or liquidator appointment. Any potential conflict of interest will be for the insolvency practitioner, the court, and interested parties to assess at the time the office-holder is appointed.

3.47 In relation to the nature of a write-down manager's liability, and as with other professional roles, a write-down manager could be liable for damages in the case of negligence or wilful default[9]. It will not be a statutory requirement for a write-down manager to hold professional indemnity insurance. However, this type of insurance would be expected, and its absence could be a basis on which the PRA declines to consent to an

[9] One exception to this would be where the write-down manager is a member of PRA staff, given that legislation will make explicit that the PRA's statutory immunity will apply in this case.

application for a particular individual's appointment as a write-down manager being put to the court. Furthermore, a write-down manager will not be expected to have an indemnity out of the insurer's assets.

Other comments on Proposal Two

3.48 In response to the questions raised about periodic reporting requirements, the government will introduce a statutory requirement for write-down managers to provide reports on the implementation and execution of a write-down plan. These reports would be issued to policyholders (and other creditors), the PRA, the FCA, the FSCS, and the court, if so provided for in the court order appointing the write-down manager. However, the frequency of these reports should be specified in the court order appointing the write-down manager rather than in legislation, and based on the expected duration of the write-down and any subsequent run-off period (noting that it may be appropriate for the frequency of reports to decrease once the insurer is stabilised and in run-off).

3.49 The government agrees with respondents that the list of parties able to challenge, and apply for the removal of, a write-down manager should include a provisional liquidator, where one is in post, and will make this addition.

3.50 In relation to the discretionary powers available to a write-down manager, such as the proposed power to allow exemptions to the stay on life insurance policyholder surrender rights, the government anticipates that the PRA will consider it appropriate to set out further guidelines around these aspects of the role.

3.51 On insurance expertise as a legislative requirement: in the government's view, a specific legislative requirement for insurance expertise is not needed; however this is likely to form part of the PRA's consideration of a nominee write-down manager. For example, a candidate who meets the legislative requirements by virtue of being a licensed insolvency practitioner is still very unlikely to be approved by the PRA if they do not have relevant insurance industry experience.

3.52 The question regarding specific eligibility requirements for write-down managers is responded to above, in paragraph 3.41.

Response to Questions on Proposal Three

Whether the proposed moratorium would help to provide stability

3.53 The government agrees that the moratorium mitigates a significant risk to insurers' stability, and views the safeguards for creditors, including through hardship exemptions, as appropriate.

3.54 The point raised in relation to netting opinions is responded to below in paragraph 3.57.

3.55 For clarity, the government is proposing that a moratorium on legal action will apply while an insurer is the subject of a write-down procedure, with similarities to the moratorium set out in paragraphs 40-44 of Schedule B1 to the Insolvency Act 1986. This moratorium will prevent creditors from taking legal action to recover debts, and prevent secured creditors from exercising security. This is independent of the proposed moratorium on termination rights (so called 'ipso facto' clauses) which arise purely as a result of an insurer entering financial difficulties or being subject to an insolvency or restructuring procedure (including a write-down process), in financial and service contracts.

The terms on which insurers are able to enter financial contracts

3.56 The government agrees with those respondents who suggested that a material impact on the pricing of financial or service contracts is generally unlikely, given that the moratorium will not prevent a counterparty terminating for breach of contract, including for ongoing non-payment. Moreover, the application of the moratorium is likely to be preferable for creditors compared to the disorderly failure of the insurer.

3.57 In response to the concerns raised regarding the potential impact on netting opinions, and therefore on the cost and availability for insurers generally of entering into derivatives (regardless of whether they go on to use the write-down procedure), the government will introduce a targeted exemption for set-off and netting arrangements (and associated security and title transfer arrangements). In arriving at this position, the government notes that the moratorium only prevents termination by reference to the write-down process (and certain insolvency procedures). The moratorium will not prevent termination for ongoing non-payment during the period of the moratorium, nor will it impact the operation of close-out netting once termination occurs. However, the moratorium would have prevented contractual termination on an ipso facto basis and this itself has raised concerns from certain respondents about the impact of the loss of this termination trigger. The proposed exemption from the moratorium will use the concept of 'protected arrangements' provided for in section 48P of the Banking Act 2009. In the government's view, this exemption will remove the risk of the moratorium affecting the ability of insurers' counterparties to obtain satisfactory netting opinions. While this will inevitably reduce the effective scope of the moratorium, the government considers that this appropriately balances the need to reduce risks to individual firms from contractual termination with the need to avoid inadvertently impacting firms more widely. In balancing these considerations, the government also notes that the firms which may be most likely to use the write-down procedure tend not to have material derivative portfolios, and so are less likely to be affected by the 'protected arrangements' carve-out. As practice develops, the government may return to this point, and is proposing to take a delegated power to amend the scope of this moratorium.

3.58 The government does not anticipate that a significant number of affected parties will choose to reword contracts in an attempt to circumvent the effect of the moratorium. However legislative drafting will be undertaken with this avoidance risk in mind.

The impact of the proposed moratorium on counterparty rights

3.59 The government agrees with respondents that appropriate safeguards for the rights of counterparties will be important. The government will introduce a hardship exemption process available in cases where the moratorium could cause hardship to counterparties. The consultation paper[10] set out that the court would have a power to amend the scope of the moratorium where this benefits the purposes of the write-down or administration. After consideration, the government will limit this power to narrowing (rather than extending) the scope of the moratorium. This means that the court will be able to exempt contracts where termination is not judged to present a risk to the insurer's operational continuity, but will not be able to bring additional contracts into the scope of the moratorium. In addition, HM Treasury will take a power to alter the default, statutory scope of the moratorium, via secondary legislation. This will allow the government to update the scope on an ongoing basis as needed.

3.60 In addition to these safeguards, and following feedback, the government has also decided to reduce the default duration of the moratorium to 6 months, rather than the 12 months set out in the consultation document. This is to balance the need for breathing space with the rights of individual creditors.

3.61 The government does not see it as necessary for the write-down manager to have a power to exempt firms from the moratorium, given that hardship as a result of the moratorium is expected to be very rare. In contrast, the write-down manager has been granted this power in relation to the stay on life insurance policyholder surrender rights ('Proposal Four'), where it is appropriate for policyholders to be able to secure an exemption without going through a court process.

Other comments on Proposal Three

3.62 The question as to whether an insurer subject to write-down would be able to underwrite new insurance business is addressed above, in paragraph 3.11.

3.63 In response to questions raised as to why the proposed moratorium should apply during administration but not during winding-up, the government views this approach as striking a fair balance between an insurer's need for protections and 'breathing space' during financial distress, and the rights of creditors. While administration may lead to sale or recovery, winding-up is generally a terminal procedure. While, in certain cases, firms in liquidation can return to viability, the government's view is that it would not be proportionate to limit the contractual rights of creditors in order to protect a firm which is likely to be beyond the point of recoverability. As such, the proposed moratorium will terminate when the court sanctions a winding-up order in respect of an insurer.

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10 See paragraph B.126 of the government's consultation paper, available here: https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/987949/Amendments_to_the_Insolvency_Arrangements_for_Insurers.pdf/.

3.64 The points raised regarding the interaction of these proposals with plans for a specific resolution regime for insurers, and potential impacts on the pricing of financial contracts, have been addressed above in paragraphs 3.12 and 3.57 respectively.

Response to Questions on Proposal Four

Whether the proposed stay would help provide stability and better outcomes

3.65 The government agrees that the proposed stay would provide important protection against the plausible risk of widespread policy surrenders.

3.66 The government has noted concerns regarding the effect of the proposed stay for policyholders who are making (comparatively small) regular or semi-regular withdrawals from their life insurance policies as a source of income. It is not the government's intention to prevent this type of 'business-as-usual' surrender, but rather to prevent 'extraordinary' surrenders motivated purely by concern regarding the insurer's financial position. While these policyholders would already be able to apply for a hardship exemption from the proposed stay[11], the government appreciates that this process could delay access to a policyholder's regular income. As such, the government will introduce an exemption, allowing withdrawals (which may be termed 'partial surrenders') of up to 5% of the policy value per 12-month period for which the stay is in force. The figure of 5% will allow policyholders to continue to take small, regular withdrawals from their policies while also protecting the insurer against larger, more disruptive surrenders. Should individual policyholders need to make withdrawals above this 5% limit, they will be able to apply for a hardship exemption.

3.67 The government has also noted concerns that rights to transfer a policy from one insurer to another operate similarly to surrender rights (from the first firm's perspective), and could present a similar risk to an insurer in financial difficulties. In response, the government will clarify that the proposed stay will apply to transfer rights as well as surrender rights. As noted in the government's consultation paper, the stay will not by default cover internal 'switching' rights (i.e. a right to switch between different funds operated by the same insurer), but a write-down manager or administrator will be able to block these rights where their use could be detrimental to the insurer's financial position. The government will also extend this power to a provisional liquidator where no write-down manager or administrator is in post.

3.68 In relation to the question on the securitisation of surrender rights, the government notes that where an insurer has entered into arrangements that are incompatible with the operation of the proposed stay, various parties (including the PRA and any appointed write-down manager) will be able to apply to the court for a reduction in the scope, or full termination, of the

[11] See paragraph B.160 in the government's consultation paper, available here: https://www.gov.uk/government/consultations/amendments-to-the-insolvency-arrangements-for-insurers-consultation.

stay. However, the government does not expect such arrangements to be common.

Whether the proposed stay would help provide stability and better outcomes The Impact of the proposed stay on policyholder rights

3.69 The government agrees with respondents regarding the importance of any hardship applications being processed quickly and efficiently. The proposals set out in our consultation paper make it possible for a write-down manager or administrator to grant hardship exemptions to policyholders without the need for a court application.

3.70 Regarding the possibility of automatic exemptions in the case of serious illness or death, it is important to note that death is likely to be a maturity event, and the stay would not affect the normal operation of the policy in this case. While an automatic exemption regime would be difficult to operationalise, serious illness is one of the scenarios in which the government envisages hardship exemptions being available. As set out above, the government has taken steps to ensure such exemptions can be obtained without the need for a court application.

3.71 In addition to this safeguard, and following feedback, the government has also decided to reduce the default duration of the stay to 6 months, rather than the 12 months set out in the consultation document. This is to balance the need for breathing space with the rights of individual policyholders.

3.72 Regarding the requirements placed on an insurer under these proposals, the government's view is that a duty for requirements to be met 'as soon as practicable' is appropriate, to ensure an insurer is not penalised where practical impediments make it difficult to meet requirements in full, despite best efforts. This could arise, for example, due to practical difficulties in identifying and contacting all of an insurer's policyholders where policies have been arranged by brokers or other insurance intermediaries or transferred from other insurers. It is important to note that during any insolvency or restructuring process, including a write-down, the insurer will continue to be regulated by the PRA and the FCA, and the full suite of regulatory powers and enforcement actions will remain available where an insurer fails to take appropriate steps to meet requirements.

Further comments on Proposal Four

3.73 The government has responded above to points raised around the need for hardship exemptions to be easy to access and time limits for complying with requirements on insurers in relation to the stay.

Response to Questions on Proposal Five

The government's proposal to ensure FSCS-protected policyholders are not left worse-off by a write-down as compared to insolvency

3.74 The government agrees with respondents that the proposed changes offer a fair outcome for protected policyholders, who could currently be left worse-off following a section 377 write-down than they would be in insolvency.

3.75 It is important to note that non-FSCS-protected policyholders' interests will be protected by the court test for sanctioning a write-down, which requires that creditors including policyholders (as a whole) are expected to be better off than under the next most likely alternative (i.e. where the write-down is *not* ordered). The government's view is that further specific protection for non-FSCS-protected policyholders is not required, given that a write-down will only be sanctioned where it is expected to lead to better outcomes for creditors as a whole. The government also notes that only a small number of types of insurance are not protected by the FSCS[12].

3.76 In relation to overseas policyholders, nothing in these proposals will affect eligibility of these policyholders for FSCS compensation. Those who are currently eligible for protection are expected to be eligible for the proposed expanded protection in the event of a write-down, and the government is not proposing to alter the status quo in this area.

Further comments on Proposal Five

3.77 The government does not expect FSCS funding costs to increase as a result of these proposals. While new FSCS 'top-up payments' will be introduced in a write-down scenario, it is important to note that FSCS compensation would also be triggered in the event of insurer insolvency, the likely counterfactual absent a write-down. The government does not expect the cost to the FSCS of providing 'top-up payments' to generally be higher than the cost of paying compensation in insolvency, particularly given that the FSCS will be able to make recoveries if the insurer's financial position later recovers sufficiently to allow for a (full or partial) reversal of the write-down. Moreover, by reducing value destruction and the extent of losses for policyholders, a write-down may in fact reduce the level of funds which the FSCS is required to provide. Importantly, the same individual compensation limits will apply following a write-down as would apply in insolvency, meaning that policyholders will not receive more from the FSCS than they would currently if their insurer were to fail.

3.78 Cost-benefit analysis for this change will be carried out as part of a full regulatory impact assessment before legislation is brought forward for these proposals.

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12 The FSCS protects eligible policyholders to 100% of the value of their policy for life insurance and some general insurance policies. Most other types of general insurance are protected to 90% of the value of the policy. A small number of policy types, such as marine, aviation, and credit insurance, as well as reinsurance, are not protected by the FSCS. For more details see the FSCS website: https://www.fscs.org.uk/what-we-cover/insurance/.

Chapter 4
Next Steps

4.1 The government will continue to consult with the PRA, the FCA, the FSCS, and the Insolvency Service in relation to these proposals.

4.2 The government intends to legislate for these proposals when parliamentary time allows.

Annex A
List of Respondents

A.1 The government received consultation responses from the following:

- The Association of British Insurers
- The Centre for Commercial Law, University of Aberdeen
- The City of London Law Society Insolvency Law Committee
- Freshfields Bruckhaus Deringer LLP
- The International Underwriting Association of London
- Interpath Advisory
- Mazars LLP
- PricewaterhouseCoopers LLP
- Teneo Restructuring

HM Treasury contacts

This document can be downloaded from www.gov.uk

If you require this information in an alternative format or have general enquiries about HM Treasury and its work, contact:

Correspondence Team
HM Treasury
1 Horse Guards Road
London
SW1A 2HQ

Tel: 020 7270 5000

Email: public.enquiries@hmtreasury.gov.uk