HM Treasury

Introducing an Insurer Resolution Regime:

Government Response to Consultation

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Chapter 1
Executive Summary

1.1 On 26 January 2023, HM Treasury published the consultation document, 'Introducing an Insurer Resolution Regime (IRR)'. The consultation ran from 26 January to 20 April 2023, and the Government received 13 written responses. During the consultation period, the Government also ran several engagement sessions, alongside the Bank of England ("the Bank"), to ensure a wide range of stakeholders were given the opportunity to engage directly with HM Treasury on the proposals. The summary below reflects both the verbal responses provided in these sessions, as well as the written responses to the consultation.

1.2 The consultation sought views on the proposed introduction of a new resolution regime for insurers, which would provide the Bank with new powers and greater flexibility to resolve a systemic insurer in the event of its failure.

1.3 Overall, respondents were supportive of the proposed introduction of the UK resolution regime for insurers and were broadly in agreement with the proposed framework, noting support for the introduction of a regime aligned to international standards and guidance.

1.4 As explained more fully in the paragraphs below, comments were made in relation to the legal scope of the regime, how the proposed powers would apply in practice, and how the regime would interact with the existing insolvency architecture. Comments were also made on the time needed to implement the new regime, and the potential for various costs to be incurred by industry when implementing the IRR proposals. In line with the Government's overall approach, respondents noted that a proportionate approach should be pursued.

Chapter 2

Policy Background and Regime Objectives

Policy Background

2.1 The UK insurance sector is the fourth largest in the world providing a wide array of important services for households and businesses which facilitate the management and reduction of risk, investment and long-term savings and the provision of retirement income. In addition, insurers are significant employers and investors, with £2.7 trillion in assets, and they make a material contribution to UK financial services exports and to UK tax revenues.[1]

2.2 In December 2022, the Government concluded its review of Solvency II - the prudential regulation regime for insurers. These reforms aim to ensure that the UK's new prudential regulation regime, or Solvency UK, is better tailored to support the unique features of the UK sector and the UK regulatory approach post EU Exit.[2] Under these reforms, the Government considers that the UK's insurance sector will remain well-capitalised and resilient to shocks.

2.3 Nonetheless, insurers can experience unexpected financial difficulties and, in rare cases, fail, with potential negative impacts on policyholders, other insurers and the wider economy. Currently, certain tools are available to manage insurer failure under the UK's insolvency arrangements, which for insurers are a modified version of the standard corporate insolvency arrangements and other restructuring provisions. These arrangements may be less effective in managing the failure of insurers in scenarios with implications for UK financial stability, including the failure of: (1) one of the largest firms, especially a rapid failure; (2) multiple insurers concurrently; and (3) insurers offering 'niche' business lines where replacement or substitute cover cannot easily be obtained.

2.4 Introducing an IRR seeks to provide the UK authorities with new powers and tools to effectively manage the failure of a systemic insurer or multiple insurers as outlined above. Such a regime would provide the Bank with powers to take prompt action to stabilise and manage an insurer that is failing or likely to fail, subject to appropriate safeguards. In the banking sector, the swift and decisive resolution of Silicon Valley Bank UK (SVB UK) demonstrated how the UK's existing resolution framework enhances UK financial stability. Similarly, providing the tools to stabilise

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[1] Please refer to the Bank of England's insurance aggregate data annual report: https://www.bankofengland.co.uk/statistics/insurance-aggregate-annual-data-report

[2] When referring to the prudential regulation regime for insurers in subsequent sections of this consultation response, the Government retains the use of Solvency II to reflect the current UK statute book. However, the Government notes that the new prudential regulation regime for insurers will be referred to as Solvency UK in the upcoming legislation implementing the previously announced reforms.

and manage the failure of a large insurer in an orderly manner, the IRR would facilitate the:

- Preservation of UK financial stability, including the provision of critical services;
- Protection of policyholders, including continuity of cover;
- Reduction of costs to industry in comparison to a lengthy insolvency process by avoiding the significant value destruction associated with insolvency;
- Maintenance of public confidence in the UK insurance sector by ensuring that even systemic insurer failures can be managed in an orderly manner, thus making the UK a more attractive place to do business; and
- In the long-term, promotion of effective competition in the market, including mitigating risks to economic growth and public funds.

2.5 The introduction of an IRR will also ensure the UK remains at the forefront of international standards. The Financial Stability Board (FSB) sets out that the objective of an effective resolution regime is to manage the failure of financial institutions and their critical economic functions without causing severe disruption or relying on public funds while also respecting the hierarchy of claims in liquidation. The Key Attributes of Effective Resolution Regimes for Financial Institutions (the 'Key Attributes' (KAs)) set out the core elements that the FSB considers to be necessary for an effective resolution regime. These are important standards, and it is critical these are implemented to maintain the UK's reputation as a safe and secure market for insurance business.

2.6 Importantly, even with an IRR in place, the Prudential Regulation Authority (PRA) will continue to work with firms to support the execution of an orderly recovery or exit of firms in distress, including the use of run-off where necessary. The IRR would provide vital additional tools for cases where recovery or run-off may not be appropriate to secure the UK's financial stability, protect policyholders and public funds, and support the UK's long-term economic growth. In this regard, the IRR is aimed at complementing rather than superseding the existing market exit and insolvency arrangements available.

Regime objectives

2.7 The Government's overall objective over the course of designing the regime has been to preserve the stability of the UK's financial system, protect public funds, and ensure the UK remains a world leader in the design of its regulatory framework for insurers, contributing to the long-term growth of the UK economy. Consistent with the objectives in the Banking Act 2009 which introduced the Special Resolution Regime in relation to banking institutions, this approach has been guided by several interrelated principles:

- Protecting and enhancing the stability of the financial system of the UK;
- Protecting the policyholders of the firm(s) in resolution;
- Protecting and enhancing public confidence in the stability of the financial system of the UK;
- Protecting public funds;

- Avoiding interference with property rights; and
- Ensuring consistency with international standards, including FSB standards and guidance.

2.8 As set out in the consultation document, the Government has continually considered the different capital structure and risk profile of insurers compared to other financial institutions in designing the policy approach to ensure the proposed IRR is tailored and proportionate to the specificities of the insurance sector. In this regard, the Government considers that its proposals to provide the Bank with the outlined stabilisation options, tools and ancillary powers is appropriate to meet these objectives. In addition, the regime includes robust safeguards, such as the Resolution Conditions (RCs) and provisions for 'no creditor worse off' (NCWO) compensation, which have been modified to align appropriately with the insurer context while meeting international standards.

Chapter 3
Summary of Responses

3.1 The Government received 13 written responses to the consultation. The Government asked fourteen consultation questions, covering various features of the proposed regime. The responses received for each question have been summarised below.

Question 1: To what extent do you support the Government's intent to implement the relevant international standards in the proposed regime?

3.2 Eleven respondents answered this question. The vast majority of respondents were explicitly supportive of the Government's intent for the regime to align the UK to Financial Stability Board (FSB) and International Association of Insurance Supervisors (IAIS) standards.[3] The majority of these respondents highlighted the Government should ensure these standards are tailored to the UK insurance sector as appropriate.

3.3 Some respondents suggested that an alternative approach could also be considered where targeted changes are made to existing procedures for managing insurer failures.

3.4 One respondent stated their view that international standards exclude UK branches of foreign insurers from within the legal scope of insurer resolution regimes where a binding obligation to respect resolution by the home authority exists, referring to footnote 4 in paragraph 7.3 of the KAs. This specific point was raised by other respondents in answer to Question 3.

Question 2: To what extent do you support the introduction of a single Resolution Authority (RA) under the proposed regime?

3.5 Eleven respondents answered this question. The majority of responses expressed support for the Bank's proposed role as Resolution Authority (RA). Most of these responses noted the Bank's existing responsibilities as RA for the banking and central counterparty (CCPs) resolution regimes, and agreed with the Government's view that a single RA will best allow for agile and decisive resolution action to be taken where appropriate.

3.6 Most respondents noted the PRA's role as the UK's supervisory authority, and asked for clarification around how the PRA would interact with the Bank's prospective role as RA. Four respondents explicitly agreed with the Government's ambition to avoid duplication between the PRA and Bank in their respective roles. Similarly, some respondents set out that it would be important for the PRA and

[3] Please refer to the FSB's Key Attributes of Effective Resolution Regimes for Financial Institutions and the IAIS Insurance Core Principles, in particular ICP 12 (Exit from the Market and Resolution).

Bank to coordinate their activities effectively where possible, in order to reduce burdens on firms across the supervisory and resolution regimes.

3.7 Some respondents noted there is scope for real or perceived conflicts of interest between the Bank and PRA, indicating a robust governance framework is required to ensure supervisory and resolution mandates are separated as appropriate.

3.8 Respondents also raised several further considerations related to the Bank's prospective role as RA, including that:

- Section 30C of the Bank of England Act 1998 requires the Bank, as RA, to make arrangements to ensure that the discharge of its resolution functions is operationally independent of the discharge of functions at the PRA, and to issue a statement detailing this separation.
- Maximum engagement from the RA with both the PRA and FCA should ensure coordinated approaches to minimise burdens on insurers. Relatedly, the Government should set out how the RA is intended to interact with the existing supervisory and insolvency architecture to ensure this is clear to industry.
- The regime is likely to place additional resourcing pressures on the Bank.
- Insurers and credit institutions operate with distinct business models, and this might limit the extent of the Bank's relevant experience in operating the UK's existing resolution frameworks.
- The Bank might lack experience in resolving complex group entities, such as insurers with asset management or financial advisory components, and that the Government should set out whether there might be impacts on non-insurance parts of a group entity subject to resolution.

Question 3: Do you agree with the proposed scope of the regime?

3.9 Twelve respondents answered this question, with these responses setting out mixed degrees of support for the Government's proposals regarding the legal scope of the regime. Approximately half of respondents were broadly supportive of or neutral on the proposed legal scope to extend to all insurers holding Part 4A permission under the Financial Services and Markets Act (FSMA) 2000, aside from the outlined exceptions.[4]

3.10 One respondent considered the broad legal scope suitable, agreeing with the Government that only a handful of insurers could, in practice, meet the statutory RCs.

3.11 A number of respondents expressed concern that UK branches of foreign insurers were included within the legal scope of the regime. Two respondents cited a footnote in sections 1.1 and 7.3 of the FSB KAs asserting branches should be exempt from host country resolution regimes where the entity's home jurisdiction is subject to resolution rules. Likewise, one respondent asserted that UK branches of foreign insurers and reinsurers should be in the scope of the relevant group's

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[4] As set out in paragraphs 4.32 to 4.37, the Government has since amended the legal scope of the regime to prospectively include insurers holding a Schedule 2A permission with a UK branch, subject to implementation of the Gibraltar Authorisation Regime (GAR).

‘home’ resolution regime rather than a local UK regime, as mandated under the IAIS’ Insurance Core Principle (ICP) 12.

3.12 Four respondents focused on the proposed exclusion of Lloyd’s from the regime, demonstrating mixed degrees of support for the proposals. Some were supportive of the exclusion of Lloyd’s from the regime, noting existing failure arrangements comparable to the proposed IRR and its unique structure making the IRR challenging to apply. However, others highlighted the potential of Lloyd’s to pose systemic risks and queried whether it was therefore appropriate for them to sit outside of the regime, querying any adverse impacts this might have on competition between insurers. One respondent suggested that the exclusion of Lloyd’s should also be extended to UK branches of foreign insurers which are part of Lloyd’s wider corporate structure.

3.13 Respondents also made several other points concerning the proposed legal scope of the regime, including that:

- The regime scope should consider third-party relationships, particularly given many insurers are reliant on third parties to deliver key aspects of their services, and thought should be given to how contracts for these services will be treated in resolution.
- Further information on how the proposed regime would apply to holding companies, or other regulated or non-regulated entities within the corporate group of an insurer, would be helpful.
- Clarity on both how the RA would engage with other domestic and international regulators, and how these processes would interact with the treatment of UK branches of foreign insurers, would be helpful.
- Some insurers provide specific, non-substitutable products or services that are important to the wider financial system and economy, and could therefore have a systemic impact despite having a comparatively small number of policyholders. Therefore, any criteria for pre-resolution planning should be carefully calibrated to include such firms.

Question 4: Do you agree with the proposed approach for entry into resolution (i.e. the RCs), including that this is not set at a fixed level of Solvency Capital Requirement (SCR) or Minimum Capital Requirement (MCR) breach?

3.14 Ten respondents answered this question. Most were explicitly supportive of the absence of a hard trigger for resolution action based on the Solvency II ladder of intervention, such as an SCR or MCR breach or a specific coverage ratio. On this point, a large portion of respondents highlighted insurer failure could manifest in various ways, and it would therefore be appropriate for the PRA to retain flexibility in determining what constitutes failure or likely failure for the purposes of an assessment of RC 1.

3.15 However, some respondents set out that it would be helpful for the Government to provide illustrative examples of when an insurer might be judged by the PRA to meet the “failing or likely to fail” (FOLTF) test under RC 1.

3.16 Some respondents noted the Government should clarify how the RCs, particularly the PRA’s judgment on RC 1, will interact with the enhanced write-down powers introduced under section 377A FSMA 2000. Similarly, one respondent set out an illustrative example of a hypothetical failure which might be managed using the proposed IRR or enhanced write-down power, and suggested the Government should clarify how the RA and PRA would coordinate to manage this scenario.

3.17 A small number of respondents considered the interactions between the proposed approach for entry into resolution and the proposal to undertake an independent valuation:

- One respondent flagged that the independent valuation would take substantial time to undertake, which might delay the process for entry into resolution and worsen outcomes for policyholders.
- One respondent set out that there might be circumstances where dysfunctional markets create asset values that are artificially low and/or highly volatile due to a lack of liquidity, with potential implications for NCWO compensation.
- One respondent considered that it would be appropriate for legislation to explicitly reference an actuary being engaged as a central part of the independent valuation process.

3.18 One respondent noted that while a flexible approach to applying the RCs would be required, it could be equally important for the regime to incorporate a minimum fixed criteria for the FOTLF test, perhaps by reference to the Solvency II regime. Further, the respondent suggested it would be sensible for the authorities to clarify how the FOLTF test is intended to interact with the Solvency II ladder of intervention provisions and the rectification period for firms found to be non-compliant with the SCR and/or MCR.

3.19 One respondent welcomed the Government's view that a firm judged to hold sufficient capital to safely undertake a solvent run-off would be very unlikely to meet the RCs and therefore enter resolution.

3.20 Respondents also made some further observations concerning the proposed approach for entry into resolution, including that:

- The range of justifiable interpretations of RC 1 could have significant implications on the available resolution actions at different points in time, and the new legal concept of 'doubtful solvency' might be relevant here.
- It is likely that if a struggling firm reaches the point whereby an independent valuation is required then failure is likely to be inevitable at that point, due to the loss in confidence in that firm that will ensue across the markets.
- It would be useful to clarify how other regulatory and supervisory tools might be used to promote the conditions for safe run-off (including in a way that avoids the need to put a firm into resolution at all).

Question 5: Do you agree it is not appropriate for the bail-in stabilisation option to include the introduction of minimum requirements for own funds and eligible liabilities (MREL) or bail-in bonds for insurers?

3.21 Eight respondents answered this question. All respondents were supportive of the Government's proposals not to introduce an MREL-type/bail-in bonds requirement to fund the regime, with most responses agreeing with the Government's views in paragraph A.50 that the fundamental differences between banks' and insurers' business models, including their respective capital, liability and funding structures, indicate that MREL is less appropriate in an insurance resolution context.

Question 6: Do you support the proposed role of the Financial Services Compensation Scheme (FSCS) in protecting certain policyholders under the bail-in stabilisation option?

3.22 Nine respondents answered this question. All respondents were broadly supportive of the Government's proposals to utilise the FSCS to provide protection to eligible policyholders following a bail-in.

3.23 Three respondents queried whether the FSCS possesses the operational capacity to implement the proposals and deliver the intended protection to eligible policyholders following a bail-in.

3.24 One respondent highlighted that it was unclear how write-downs under the bail-in option would apply to reinsurance floating charge holders, noting it was unclear whether cedants would be treated similarly to direct policyholders (unsecured but protected by statutory priority) to eliminate any inadvertent distinctions between these creditors.

3.25 Respondents also provided a range of other insights on the proposed provision of FSCS top-up payments following a bail-in resolution, including that:

- Some policyholders might require continuity rather than a cash payment, for example as a requirement to continue trading, and therefore the Government should consider FSCS-financed transfers of particular policies.
- FSCS top-up payments provided under the bail-in option should not extend further than current eligibility rules for FSCS protection.
- Were future premiums to be correspondingly reduced to the percentage size of write-down then there might be an impact on FSCS top-up payments, but if they remain the same then policyholders are likely to be disincentivised to continue paying full premiums.
- FSCS compensation might be more complex for with-profits policies, where the future benefits are not guaranteed, and more time may be needed to determine appropriate treatment for these policyholders.
- The Government might wish to consider scope for adverse tax consequences for life policyholders were they to receive top-up payments from the FSCS, given these payments might not be deemed to have been made by an insurance company under existing tax legislation.

Question 7: Do you have views on how a firm's existing shareholders and subordinated creditors should be treated under the bail-in stabilisation option?

3.26 Eight respondents answered this question. A large majority of respondents agreed with the Government's proposals that shareholders should absorb losses before creditors are written down following a bail-in, in line with the banking resolution regime and the KAs.

3.27 However, the majority of respondents were neutral or did not express strong views with regards to when and how a bail-in resolution should be executed. Most respondents suggested the regime should maintain scope for the RA to execute a bail-in flexibly in accordance with specific circumstances, given the potential for a range of failure scenarios.

3.28 Respondents also referenced further considerations related to use of the bail-in stabilisation option, including that:

- The bail-in option presents a tension between different points of intervention and prospects of fair outcomes for shareholders and policyholders.
- Successful use of the bail-in option would need to balance shareholder dilution against the RA's objectives when using the powers, including the need for shareholders to support a solvent run-off.
- A failing insurer could satisfy RC 1 while residual equity remained in the firm, meaning a bail-in could be justified where shareholders are displaced when non-negligible equity remained in the failing firm.
- It is unclear how the revised section 377A FSMA 2000 powers interact, if at all, with the proposed bail-in stabilisation option, given a key component of each proposal is to write down the value of an insurer's liabilities in line with the creditor hierarchy.

Question 8: Do you agree with the proposed scope of the NCWO safeguard and compensation, including the approach to calculating the counterfactual?

3.29 Six respondents answered this question. All respondents were broadly supportive or neutral on the Government's proposed approach to the NCWO safeguard. Most responses reflected on the actuarial challenges likely to be involved in any valuation of future claims, and considered how the overall compensation framework could function effectively.

3.30 Some respondents explicitly noted that a key methodological challenge to the independent valuation process underpinning the NCWO safeguard is likely to be actuarial estimation of future claims, with these respondents stressing that valuation principles should be clearly set out in legislation to ensure actuarial assessments are sufficiently focused and targeted.

3.31 One respondent considered the differences between the consultation proposals and the European Union's (EU) proposed Insurance Recovery and Resolution Directive (IRRD). In the respondent's view, the EU proposals incorporate a definition of the NCWO safeguard which can be applied at the date of resolution more effectively, and avoid uncertainties around the value and likelihood of future claims.

3.32 One respondent suggested the Government should clarify whether the independent valuation conducted following resolution will be conducted on a point-in-time or continuous basis. The response highlighted that the former approach would align with the banking context, whereas the latter would allow for periodical assessments better capturing the likelihood of fluid values, in particular for life insurance policies.

3.33 One respondent listed challenges which might arise when applying the NCWO safeguard, including that:

- Where the determination of NCWO compensation is calculated with explicit reference to the actual date resolution is triggered, there might be significant uncertainties in valuing liabilities to creditors, whereas determination later might reduce potential uncertainties.
- It might be most efficient to assess NCWO for a group of similar policyholders rather than on an individual basis. For example, the valuation of annuities and life cover can vary significantly for an individual policyholder depending on, for instance, the mortality assumptions employed (and their granularity).
- Payments on with-profits policies could vary significantly depending on how they are assessed, and any surplus in previously ring-fenced with-profits funds should be distributed.

3.34 One respondent expressed the view that a helpful determinant with regards to whether policyholders will or will not be worse off following resolution action might be drawn from the Part VII FSMA 2000 transfer context, namely a formulation based on 'not expected to be materially worse off'. This would enable the RA to take a sensible view based on their assessment at the time, ensuring it is not constrained by the NCWO compensation requirements in future. The respondent noted consumers and small and medium-sized enterprise (SME) policyholders will retain FSCS protection, indicating this approach could provide a pragmatic way forward.

3.35 One respondent asked whether creditors, including policyholders, who receive less following a successful transfer to a private purchaser or a bridge institution than they would have done in insolvency will be protected by and compensated through the NCWO safeguard.

3.36 One respondent questioned which entity would pay NCWO compensation claims where it has been determined that NCWO compensation is required but HM Treasury is not the entity specified in the compensation scheme order, and whether this entity would depend on the stabilisation option deployed (e.g., the transferee in the case of the private sector transfer option).

Question 9: Considering the requirements of the KAs, do you agree with the proposed approach to pre-resolution planning?

3.37 Ten respondents answered this question. No respondents disapproved of the Government's overall proposal for systemically important firms to be subject to pre-resolution planning under the regime, with a large majority of respondents stressing that duplication with existing supervisory requirements should be avoided and new planning requirements must be proportionate.

3.38 A significant proportion of respondents agreed with the Government's intent, detailed in paragraph A.86 of the consultation, to ensure that the pre-resolution planning mandated by the RA minimises duplication in activities undertaken by the PRA and the Bank under the prospective ease of exit and resolution planning regimes.

3.39 Some respondents noted that it would be helpful for the Government to provide further detail on the RA's approach to Resolvability Assessments, especially the frequency of such assessments and how these would be coordinated with firms.

3.40 A small number of responses suggested it was unclear what action the Bank could take to remedy barriers to resolvability. One respondent set out that any action taken by the RA to enhance resolvability should be proportionate to the systemic risk posed by the firm. One respondent considered that any action to enhance resolvability should be coordinated with actions taken by the PRA.

3.41 Respondents provided some other comments on the Government's intention to introduce pre-resolution planning requirements on eligible firms, including:

- Diverse views on the application of pre-resolution planning requirements, with some respondents saying that further clarity on their application was required, and others suggesting they should be applied to a wide pool of firms.
- That introducing planning waivers could simplify potential overlaps between ease of exit and pre-resolution planning undertaken by the PRA and Bank respectively.
- That any pre-resolution planning measures going beyond what is mandated under international standards were likely to impact the UK's international competitiveness and limit prospects for growth.

Question 10: Considering the requirement of the KAs, do you have views on how a restriction of policyholder surrender rights in resolution should be structured (including for example, the appropriate length of this restriction)?

3.42 Five respondents answered this question. All respondents were supportive of the proposal to introduce a restriction on life policyholder surrender rights following resolution action, though no respondents set out what they judge the appropriate length of the restriction might be.

3.43 Some respondents considered that it would be difficult to determine, *ex ante*, how long restrictions on surrender rights should continue given the appropriate length in any given failure scenario will depend on the factors which lead to resolution action being taken.

3.44 Some respondents judged that similar restrictions should be introduced to mitigate the similar risks posed by switching rights and pensions transfers, which could destabilise a resolved insurer in a similar manner to policyholder surrenders *en masse*.

3.45 A small number of respondents noted the Government should consider incorporating a hardship exemption to account for policyholders reliant on savings policies as a main source of income, ensuring such individuals are not unfairly penalised by use of the restrictions.

3.46 One respondent queried whether the surrender rights restriction could create additional tax liabilities for relevant policyholders and, if so, whether such liabilities would factor into any considerations around NCWO compensation.

Question 11: To what extent will the proposed ancillary powers support an effective resolution?

3.47 Nine respondents answered this question. A large majority of responses were supportive of the ancillary powers proposed, and many judged the proposed powers would have wide-ranging and material impacts that would allow the RA to implement the stabilisation options and tools effectively.

3.48 A small number of respondents considered that use of the ancillary powers by the RA should be targeted to ensure both an effective resolution and that potential harms are mitigated in the most proportionate manner possible.

3.49 One respondent specifically discussed the proposed power to restrict payments of dividends to protect a resolved firm's capital, and queried how these powers would interact with new Companies Act legislation strengthening firm-level rules on dividend payments and capital maintenance.

3.50 One respondent questioned whether the ancillary powers could be made more effective by allowing the RA to provide credit or liquidity support to an insurer with immediate liquidity issues.

3.51 One respondent expressed concerns about the viability of these proposals in the absence of contractual recognition clauses for the use of powers to stay *ipso facto* termination rights for non-UK law governed contracts.

Question 12: What lead-in time would be appropriate for industry to prepare for the proposed regime? Are there any elements of the proposed regime that would not require a lead-in time?

3.52 Nine respondents answered this question. A large majority of respondents suggested that industry would require a minimum 12-month lead-in time to implement the requirements envisaged. Some respondents suggested that a longer 18 – 24-month implementation period would be feasible.

3.53 A significant portion of respondents noted that precise estimates around implementation timelines would depend on the scope of pre-resolution planning mandated by the RA, and how prepared different firms might be to support this. Respondents noted existing firm-level preparation might itself depend on firms' size, business model, or risk profile.

3.54 A small number of respondents noted their firms already have plans in place to expand their recovery and resolution/exit planning frameworks, though these were at different stages of development.

3.55 Other comments on the appropriate lead-in time included that:

- A minimum 12-month period would be required to support an RA-led Resolvability Assessment, with a further 12 months minimum required to consider and address the RA's findings. The respondent noted this latter period could be longer depending on the nature and scope of the RA's findings and conclusions.
- It would be helpful for the IRR to be implemented alongside the EU's IRRD proposals, given aligned implementation timelines would reduce implementation costs for firms affected by both regimes.
- The core components of the proposed regime, such as the RCs and stabilisation options, should be introduced relatively quickly, given the

regime seeks to target systemic insurer failure which could occur suddenly.

Question 13: Do you agree with the potential impacts of introducing an IRR identified in Chapter 2? How would the proposed regime impact insurance firms' costs?

3.56 Seven respondents answered this question. The majority of respondents set out that the introduction of the regime would impose various costs on industry, and two respondents explicitly agreed with the Government's suggestions in Chapter 2 on the consultation setting out what these additional costs are likely to be.

3.57 One respondent noted that any costs associated with implementing the regime should be considered against the relevant counterfactual, namely the uncertain costs of a disorderly failure of a systemic insurer.

3.58 Some of the other potential costs identified by respondents included:

- Administrative and resource-based costs resulting from pre-resolution planning requirements, though some said it was difficult to estimate these without further detail on how they will be implemented;
- Increased costs of issuing debt at holding company level to reflect the possibility of a write-down of subordinated debt following a bail-in;
- Legal costs related to introducing contractual recognition of bail-in and stays powers for non-UK law governed contracts, which might require repapering, subject to the approach taken.

3.59 One respondent also noted that a cost-benefit analysis should be carried out by the Government, given the potential for various costs to industry as described above.

Question 14: Do you have any other comments on this proposal, or the Government's approach to insurer resolution?

3.60 Six respondents answered this question. The respondents engaged with a range of issues for this question, many of which built on responses to the previous consultation questions. The themes respondents engaged with are sub-headed below.

UK branches of foreign insurers

3.61 One respondent flagged that both the EU's IRRD and the impending reform of the Swiss Insurance Supervisory Act (ISA) include or are considering introducing a waiver for cases in which the home jurisdiction of a branch's parent undertaking is subject to a similar insurer resolution regime. The respondent suggested that the UK should consider taking a similar approach, avoiding a cross-border duplication of requirements.

Application of the regime to group entities

3.62 One respondent referenced paragraph 2.6 of the consultation to confirm that the regime would apply to mixed financial groups and asked for further clarity on how such firms would be resolved under the proposed regime.

Pre-resolution 'provisional' valuation

3.63 Referencing paragraph A.28 of the consultation, one respondent considered that it would be challenging to conduct a provisional valuation of a distressed insurer in short timescales with sufficient prudence given the likely range of uncertainties. The respondent suggested that rather than intending for a provisional valuation to be conducted with sufficient prudence, a provisional valuation range based on a range of outcomes for key assumptions and related sensitivities is likely to be preferable.

3.64 One respondent noted that insurance policy valuations, particularly in the life sector, are subject to significant assumptions and fluctuations, which could create litigation risks for the relevant authorities following resolution action.

Private sector transfer

3.65 One respondent queried how a private sector transfer will operate against the wider regulatory backdrop, such as competition law.

3.66 One respondent set out that they were supportive of introducing powers to transfer without court approval, given this is a lengthy process. However, the respondent noted there are several conflicts which the court can resolve when a Part VII transfer is undertaken, and the respondent considered it unclear how similar issues would be resolved under the IRR given the absence of the court framework. These issues included that:

- Extending ancillary powers to incorporate protections for delivering portfolio transfers at speed could include ringfencing the transferring business.
- Transferring a failing/resolved insurer at pace might mean that the acquiring entity would not be able to take the business clean of complaints, historic matters or actions arising from the IRR, creating unpalatable levels of risk for the acquirer and narrowing the pool of potential acquirers.
- The RA should also possess additional powers to disapply termination and Change in Control clauses in reinsurance contracts to prevent a resolved insurer from losing reinsurance cover prior to any transfer as it breaches its minimum solvency. The RA would have this power for English law contracts, but repapering of non-English law contracts would need to be considered.

Bridge insurer

3.67 One respondent judged that use of a private sector transfer would be unlikely, given that it is unlikely that a transfer to a private purchaser could be effected with sufficient speed to satisfy the Resolution Objectives. Therefore, the respondent considered the bridge insurer is a likely tool to be used until a willing acquirer can be identified. The respondent considered that the bridge would also act as a vehicle to clean up an insurer and preserve good assets to take value, and then create an unsaleable entity for wind-down.

3.68 One respondent asked whether an onward transfer from an interim bridge insurer to an acquiring firm would not require court approval.

3.69 One respondent contended that it is not immediately clear what benefits a bridge insurer would bring when compared to either a private sector transfer or placing the firm into safe run-off.

3.70 One respondent asserted that consideration should be given as to whether the regulators should have the discretion to apply forbearance in relation to certain aspects of the regulatory regime whilst firms are in resolution, including FCA requirements.

Bail-in

3.71 One respondent agreed that the objective of a bail-in should be to recapitalise the firm to the extent whereby the RA can ensure the firm can enter solvent run-off, rather than to write new business. However, the respondent queried whether there was scope for a bail-in to inadvertently lead to inequitable treatment between different groupings of policyholders, particularly those that lapse or mature soon after a claim event and those that remain with the firm.

3.72 One respondent specifically queried the Government's proposal to override pay-as-paid clauses within the regime, contending that this proposal runs against the principle that reinsurance covers the actual risk of the cedant insurer.[5] The respondent suggested that this proposal means that the insurer's risk is reduced but the reinsurer's risk is not reduced correspondingly, effectively providing credit support to the cedant's insolvency proceedings.

3.73 One respondent highlighted the consultation sets out in paragraph A.49 that the established creditor hierarchy will be maintained for write-down of liabilities under the bail-in option, and queried whether with-profits policyholders would rank differently from other non-participating policyholders under the hierarchy.

Temporary public ownership

3.74 One respondent asked whether the taxpayer would become the owner of last resort if no willing buyer could be found, either to facilitate a private sector transfer or take the resolved insurer out of the bridge institution.

Ancillary powers

3.75 One respondent considered that the Government should clarify whether it intends to use ancillary powers to amend existing court-approved schemes that may operate within the transferring business, avoiding uncertainty were the regime exercised.

Funding the regime

3.76 One respondent suggested the Government should consider setting out in future how the regime will be funded, while appreciating this consideration went beyond the remit of the consultation.

3.77 One respondent queried whether it was the intention for the RA to charge any costs to the insurer for any services it or others might provide including, for example, the costs of the RA appointing an independent valuer.

[5] The respondent references paragraph A.60 of the consultation, which discusses the override of pay-as-paid clauses.

Chapter 4

Government Response

4.1 The Government has carefully considered all the responses to the IRR consultation and has engaged with several respondents to further discuss certain points. The points below reflect where changes have been made to the Government's proposed approach in order to take account of the points raised, to reflect further policy development and, for certain suggestions, to provide an explanation as to why the Government has decided that no policy changes should be made.

Alignment with international standards

4.2 The Government notes the near unanimous support expressed by respondents that the proposed IRR should seek to align the UK to relevant international standards. The Government considers that full implementation of these standards as proposed will ensure the UK maintains its reputation as a leading market for insurance services. Similarly, introducing the IRR would also fulfil the recommendation made by the International Monetary Fund (IMF) to introduce such a regime in its 2016 and 2021 assessments of the UK's financial system (known as the Financial Sector Assessment Program (FSAP)).[6]

4.3 As set out in paragraph 2.16 of the consultation, the proposed stabilisation options and tools have been designed to ensure the UK fully aligns with the FSB's KAs. Noting respondents' support for the Government's intention to deliver full alignment to these standards, the Government intends to introduce the stabilisation options, tools and other requirements mandated by these standards, modified as appropriate to ensure their suitability for the UK insurance sector.

4.4 Further, the Government agrees that the stabilisation options and tools envisaged under international standards should be designed and implemented to complement the existing UK insurance market context. The Government wishes to note its intention to leverage the existing activities undertaken by the PRA in respect of pre-resolution planning requirements and its decision not to include an MREL-type requirement within the regime. These examples demonstrate the Government's intention to use the existing regulatory environment to align with international standards or, in the absence of specific recommendations, to design the regime in a proportionate manner compatible with the UK sector.

4.5 More detail has been provided in relation to the requirements of international standards concerning branches in paragraphs 4.11 to 4.18 of this response.

[6] Please refer to the IMF's 2016 and 2021 UK Financial Sector Assessment Programme for further details.

The Bank's proposed role as Resolution Authority

4.6 The Government agrees with the views expressed by the large majority of respondents that the Bank possesses considerable experience as RA under the banking resolution regime, indicating the Bank is well-suited to the proposed role as RA under the IRR. The Government agrees that the Bank's proposed appointment as a single RA will provide for swift and decisive resolution action to be taken where required, as set out in paragraph 2.4 of the consultation.

4.7 Importantly, the Bank's role as RA will not supersede or replace the PRA's usual prudential supervisory responsibilities. Instead, the Government's intention is to ensure that the Bank is well-placed to address an acute set of risks that a systemic failure may present to UK financial stability, which should leverage PRA resources and expertise where appropriate to be optimally effective. Therefore, the proposal to house both resolution and supervisory functions within the Bank's structure aims to ensure that there is close coordination between the PRA and the Bank in the planning and application of resolution decisions.

4.8 Relatedly, the Government notes some respondents' comments on the scope for real or perceived conflicts of interest between the Bank and the PRA. However, the Government wishes to draw attention to Section 30C of the Bank of England Act 1998, which requires the Bank, as RA, to make arrangements ensuring that the discharge of its resolution functions is operationally independent of its functions exercised in its capacity as the PRA. As issued after the banking resolution regime was introduced, the Government can confirm that the regime will amend the Bank of England Act 1998 to mandate the Bank to update its existing public statement to this effect upon implementation of the IRR.[7]

4.9 The Government also agrees that insurers operate using different business models to banking firms. This reaffirms the Government's intent, as set out in paragraph A.5 of the consultation, for the Bank to undertake consistent and coordinated engagement with the PRA and, where appropriate, the FCA to leverage their expertise and understanding of the sector.

4.10 It is possible that additional resources within the Bank will be needed to deliver on its expanded RA responsibilities following introduction of the IRR. How the Bank chooses to apportion these additional resources will be a matter for the Bank itself.

Regime scope

UK branches of foreign insurers

4.11 The Government has considered further whether UK branches of foreign insurers should be within scope of the regime, and references made by some respondents to the contents of the KAs on this point. In response, the Government maintains that UK branches of foreign insurers should remain in scope of the regime to ensure the regime fully aligns with international standards.

4.12 Consideration has been given to references by respondents to the contents of the KAs and whether these should result in excluding UK branches of foreign

[7] Please refer to Statement on operational independence of the resolution and supervision functions of the Bank of England. The Government intends to amend section 7D of the Bank of England Act 1998 to include insurance resolution functions, which will underpin the prospective independence between the Bank's resolution and supervisory operations.

insurers from the scope of the IRR.[8] The Government judges that references to exemptions for branches where host jurisdictions are subject to a binding obligation to respect resolution under the authority of the home jurisdiction is specifically targeted at European Economic Area (EEA) members. The exemption recognises that EEA branches of EEA firms will be resolved by the relevant Resolution Authority in the EEA (i.e., either the home authority or the Single Resolution Board (SRB)). In this respect, the Government does not consider that the exemption is relevant in the UK context, including having regard to Treaties rolled-over as part of the EU Exit process, since the UK is no longer "subject to a binding obligation to respect resolution of financial institutions under the authority of the home jurisdiction" following EU Exit.

4.13 In light of the views received from respondents, the Government notes further points on the treatment of branches within the regime, given their inclusion within the scope of the regime as prescribed under international standards.

4.14 Importantly, the Government wishes to make clear that it does not intend for the regime to impose on the Bank any statutory requirements to subject UK branches of foreign insurers to Bank-led pre-resolution planning. This aligns with arrangements in the banking regime, where the Bank does not conduct pre-resolution planning with respect to UK branches of foreign-headed banks. Relatedly, as set out below, the intention of including branches in the scope of the regime is to facilitate resolution action by a 'home' authority. Therefore, it is the Government's expectation that, relative to the status quo, the inclusion of UK branches of foreign insurers within the scope of the regime should not lead to new UK planning requirements for those branches.

4.15 However, UK branches of foreign insurers will need to remain in scope of the regime for two reasons. Firstly, in general, the responsibility to manage the failure of a UK branch will sit with the 'home' resolution authority in the jurisdiction where the insurer is headquartered. Thus, the onus will sit with home resolution authorities to develop and implement a preferred resolution strategy for foreign insurers with a UK branch.[9] Therefore, the Bank will be granted a facilitative power to give UK 'recognition' to action taken by the home resolution authority, and to exercise its stabilisation powers in respect of a UK branch to support the home resolution authority's resolution action.[10] The Government's expectation is that any additional preparation required to ensure the orderly resolution of a foreign insurer with a UK branch will generally be undertaken by the Bank as host RA, rather than branches themselves, to the extent that coordination is sought by the home resolution authorities. Were there to be a systemically important UK branch of a foreign insurer in future, the Government would expect that the home authorities would expand coordination with the Bank in proportion to the systemic risks posed by the foreign insurer and/or the UK branch.

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[8] The relevant footnote is Footnote 1 of the Financial Stability Board's *Key Attributes for Effective Resolution Regimes for Financial Institutions* as included in Section 1.1 (Scope) and Footnote 4 in Section 7.3 (Legal framework conditions for cross-border cooperation).

[9] This point is set out in A.92 of the consultation.

[10] The exercise of these powers would seek to promote objectives and outcomes broadly comparable to the proposed Resolution Objectives (and intended outcomes) anticipated from exercising the stabilisation powers and tools in relation to a UK insurer.

4.16 Secondly, in line with the banking precedent, the Bank will also have backstop powers to independently resolve the UK branch of a foreign insurer, when the Bank (with HM Treasury approval) has refused to recognise foreign resolution action or where the relevant home authority has not commenced resolution proceedings. These backstop powers would only be used if cooperation with the home authority proves ineffective and where action is required to protect the public interest in the advancement of one or more of the Resolution Objectives. The stabilisation powers would only be applicable to the business of the UK branch and to liabilities arising because of the operations of the UK branch. This approach sets a high bar for the use of the stabilisation options and tools in respect of the UK branch of a foreign insurer, and a narrow field for deploying these with respect to the activities of the wider group (unless the group also includes a UK subsidiary that is a PRA-authorised insurer). As noted above, the existence of this power is not anticipated to lead to new planning requirements.

4.17 Both the recognition power and the backstop powers are specifically required by the KAs.[11] Either power, if exercised, will be subject to HM Treasury approval. Importantly, as set out in paragraph A.111 of the consultation, the Bank will be restricted in exercising its resolution powers where HM Treasury notifies the Bank that the proposed exercise would contravene the UK's international obligations.

4.18 In summary, while the Government therefore judges it important that the UK branches of foreign insurers remain in the legal scope of the regime, it does not expect the IRR to create a need for new planning requirements for such firms. In the Government's view, the primary intent of inclusion is to give effect in the UK to the execution of a cross-border resolution led by the 'home' resolution authorities. Overall, this should ensure the UK regime takes a proportionate approach to dealing with UK branches of foreign insurers while meeting international standards.

Holding companies

4.19 In light of some of the responses received, the Government considers it appropriate to provide further detail around how the regime is intended to apply to the various financial groups and conglomerates noted in paragraph 2.6 of the consultation.

4.20 The Government judges that it is appropriate for both holding companies and individual firms to be in scope of the regime. This means that the RA is able to deploy the stabilisation powers at either the holding company level or the solo level in respect of the different group entities set out in paragraph 2.6 of the consultation. This is implied in paragraph A.54 of the consultation, which highlights that, under the bail-in option, new shares could be issued in relation to the insurance entity or its holding company, depending on the situation. In line with this, the level at which the RA would intervene would depend on the cause of failure, and the objectives of any resolution action the Bank might take.

4.21 In terms of the rationale for this design choice, international standards mandate that group entities are included within the legal scope of resolution regimes. In particular, international standards envisage circumstances where resolution action will need to be taken at the level of the head of the insurance

[11] Please refer to paragraph 7.3 of the KAs.

group and/or nonregulated entities.[12] In line with this, the legal scope of the regime will include holding companies insofar as that is necessary to resolve an insurance company or a group as a whole.[13] For non-regulated operational entities within a group entity providing services across the group, such as treasury or IT services, the standards mandate that resolution action can be taken in relation to such entities insofar as that is necessary to support the resolution of an affiliated insurance company or the group as a whole. Therefore, the IRR will provide the RA with the flexibility to intervene at the holding company or solo firm level, given either level of intervention might be required to effectively resolve an insurance company or a group.

4.22 However, the application of the regime to individual components of a group, such as the holding company or a solo level firm, is intended to be subject to additional considerations the RA must account for. In particular, when taking resolution action in respect of a group company, it is intended that the RA should have regard to minimising the effect of that resolution action taken on other undertakings in the same group. Similar principles are incorporated in the Banking Act 2009, and it is the Government's intent to mirror such provisions in the IRR.[14] This consideration means, for example, that the RA would be unlikely to deploy the stabilisation powers and tools at holding company level where insurance is a small part of wider group business.

4.23 The Government wishes to note the existing supervisory powers the PRA possesses with respect to holding companies, indicating these are precedents for the Government's proposals in relation to group entities.[15] In particular, the PRA possesses powers to give directions to holding companies ("parent undertakings") subject to satisfaction of the general condition or consolidated supervision condition and carries out work to prepare group entities to exit the market.[16] Therefore, providing the RA with the scope to apply the stabilisation powers and tools at the holding company level is not without precedent under existing arrangements. While the Government's expectation is that the RA will continue to mirror the PRA's focus at the solo-level, reserving the ability for the RA to intervene at holding company level where required is judged an appropriate safeguard to support a safe and orderly resolution.

Niche insurers

4.24 The Government agrees with respondents asserting that the failure of an insurer providing specialised and/or non-substitutable insurance products to concentrated parts of the UK market could generate significant financial or economic costs. In this respect, the Government considers that these types of firms, despite their potentially smaller size, could potentially meet RC 3 (i.e., the public interest test). Therefore, the Government expects that insurers offering specific or non-substitutable products to significant shares of the UK market will be in practical scope of the regime. This would not extend to other comparatively

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12 Please refer to section 12.7.14 of the IAIS's Insurance Core Principles (2019). Also see p.2 of Key Attributes Assessment Methodology for the Insurance Sector (2020).

13 Please refer to p.20 of Key Attributes Assessment Methodology for the Insurance Sector (2020).

14 Please refer to section 7A(2) of the Banking Act 2009.

15 The PRA possesses powers of direction over 'qualifying parent undertakings' under section 192C of FSMA 2000.

16 Please refer to PRA Statement of Policy: The power of direction over qualifying parent undertakings (April 2013).

small insurers who do not offer such products to concentrated parts of the market. The Government expects the Bank will engage with specific firms where this is identified as a relevant consideration in light of their particular products and business models.

4.25 Where niche insurers are in scope of pre-resolution planning requirements, the Government agrees that it will be important for the RA to calibrate its pre-resolution planning to reflect the idiosyncrasies of these firms and their products.

Mutuals

4.26 By virtue of holding Part 4A permission, non-friendly society mutual insurers are intended to be within the legal scope of the IRR. This mirrors arrangements in the banking regime, where building societies are also in scope. Mutuals and building societies are similar, in that both do not have shareholders and are owned and controlled by their members. The Government will therefore need to ensure the proposed stabilisation tools can be applied to the mutual structure (e.g., such as via a power to de-mutualise in certain situations).[17]

4.27 This is subject to the wider point made in the consultation that the legal scope of the proposed regime would be subject to the expectation that in practice, several important elements of the regime, such as pre-resolution planning, will be limited to a smaller group of firms. The Government anticipates that the majority of insurers would be unlikely to meet the statutory tests for resolution action and, therefore, would be put into another procedure at the point of failure.

Lloyd's

4.28 The Government carefully considered whether Lloyd's should be within scope of the regime.[18] Most importantly, the Government judged that Lloyd's is already subject to provisions comparable to the proposed IRR.[19] The Government deems that the risks Lloyd's might pose as a systemic marketplace, rather than an insurance firm or group, are thereby suitably mitigated by these regulations. For example, these regulations provide statutory objectives comparable to those proposed under the IRR, namely for a market reorganisation order to preserve or restore the financial situation of, or market confidence in, the association of underwriters known as Lloyd's.[20] Further, specific resolution arrangements allowing for centralised loss absorption and restructuring of liabilities already exist under these regulations, indicating that the IRR stabilisation options would in large part duplicate existing powers. The resolution regulations pertaining to Lloyd's, which operate under a court-based framework, have regard to its unique structure. When combined with PRA supervisory requirements on exit planning, these

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17 Please refer to sections 84ZA and 84A of the Banking Act 2009. The banking regime also includes powers to de-mutualise building societies to ensure the stabilisation options can be applied effectively.

18 In this context, 'Lloyd's' refers to the association of underwriters known as Lloyd's, the Society of Lloyd's and the members, managing agents and members' agents comprising its marketplace.

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

20 See regulation 5 (a)-(b) of The Insurers (Reorganisation and Winding Up) (Lloyd's) Regulations 2005. The test the court must assess when considering whether to make a market reorganisation order is whether any regulatory solvency requirement is not, or may not be, met and an order is likely to promote the objectives in regulation 5. This test is similar in nature to the RCs, and similar to how these are proposed to relate to the Resolution Objectives.

regulations ensure that Lloyd's will be subject to a similar level of planning as firms subject to pre-resolution planning under the IRR.[21]

4.29 Further, as noted in paragraph A.9 of the consultation, the legal form of Lloyd's makes it challenging to subject the Lloyd's marketplace, or its component parts, to the proposed stabilisation options and tools. In this respect, Lloyd's is not an incorporated insurer. Under the bail-in option, for instance, it is unclear how new shares could be issued within the Lloyd's corporate structure in respect of written down policyholders and/or creditors following a write-down of members' liabilities. This specific legal form is why separate arrangements to manage Lloyd's, and failures of and within its marketplace, exist already. Therefore, the Government considers it would be disproportionate to subject it to a regime aimed at managing the failure of systemic insurance groups and firms.

4.30 Finally, as a result of the aforementioned 2005 regulations and PRA supervisory requirements on exit planning, the Government wishes to note that Lloyd's (and potentially certain of its members, forming part of groups with dual platforms) is subject to similar levels of PRA exit planning as other firms, based on PRA rules and policy.[22] Therefore, in the Government's view, Lloyd's (and its members) will not obtain a competitive advantage arising from being outside of the scope of IRR and RA-led resolution planning, particularly given the regime aims to leverage PRA exit planning work as set out in paragraph A.92 of the consultation.

4.31 For the reasons set out above, the Government therefore judges that it would be disproportionate to extend the legal scope of the regime to include Lloyd's and maintains its intention to exclude Lloyd's from the regime as proposed in the consultation. However, in line with the proposed approach to UK branches of foreign insurers (see paragraphs 4.11 to 4.18), the regime will not include exemptions for UK branches of any foreign group or subsidiary.

Gibraltar

4.32 Although not an issue raised in detail by respondents, the Government has also further considered the position within the regime of Gibraltarian insurers with UK branches or that otherwise provide services in the UK.

4.33 Gibraltar-based insurance firms currently access the UK market by a preservation of the arrangements that were in place during the UK and Gibraltar's joint membership of the EU.[23] HM Treasury is in the process of implementing a permanent replacement regime, the Gibraltar Authorisation Regime (GAR). The GAR is not yet in place. Access to the GAR is subject to certain conditions. Should Gibraltar insurers be granted access, they will hold a Schedule 2A permission and be authorised persons under FSMA 2000, just as those with Part 4A permission are.

4.34 In the event that Gibraltar-based insurers are granted access to the UK market through the GAR, it is the Government's view that, in addition to the

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[21] The "reorganisation controller" is an officer appointed by the court. See regulation 9 of the 2005 regulations.

[22] This refers to a group with both a Lloyd's member (and often a related managing agent, and thus an aligned syndicate) and a separate insurer.

[23] The legal avenue by which insurers based in Gibraltar currently access the UK market is through a preservation of the passporting arrangement in place whilst the UK was an EU Member State. The existing passporting arrangements for Gibraltar are based on section 409 of FSMA 2000 and the Gibraltar Order 2001 and have been preserved, as amended, by the Financial Services (Gibraltar) (Amendment) (EU Exit) Regulations 2019.

position set out at consultation, the legal scope of the regime should be expanded beyond insurers holding a Part 4A permission to include insurers holding a Schedule 2A permission with a UK branch.[24]

4.35 The Government considers that the proposed IRR should apply equally to all insurers accessing the UK market through a branch, and therefore proposes to include Gibraltarian insurers with Schedule 2A permission and a UK branch within scope of the IRR. The Government considers that this change to the scope of the regime will best promote conditions for a level playing field across the UK insurance market. This amendment will ensure the proposed regime treats UK insurers, UK branches of Gibraltar-based insurers, and UK branches of other foreign insurers equitably, regardless of their home jurisdiction.

4.36 The Government judges that extending the scope of the IRR to insurers with a UK branch and holding a Schedule 2A permission is appropriate. This is because it is unlikely that the IRR will be introduced through primary legislation before the GAR comes into force, should Gibraltar insurers be granted access.[25] Therefore, the regime will accommodate Schedule 2A permission, but need not capture the current Gibraltar Order arrangements.

4.37 Given that considerations pertaining to the treatment of Gibraltarian insurers was not discussed at length in the consultation, the Government is content to engage with stakeholders as necessary if they have further reflections on these proposals.

Process for entry into resolution

4.38 The Government agrees with respondents that the process for entry into resolution should not be tied to the Solvency II ladder of intervention, such as an SCR or MCR breach or a specific level of SCR coverage. Likewise, it is appropriate for the PRA to be provided with flexibility in determining when a failure, or likely failure, has occurred for the purposes of its RC 1 assessment.

4.39 In line with the views of some respondents, the Government also considers it would be helpful to provide some further guidance to industry on how the RCs, including RC 1, may be met. The Government intends to issue further guidance as to how all of the RCs will be evaluated by the PRA, the Bank and other relevant authorities in a Code of Practice subsequent to implementation of the regime.

Interactions between the IRR and the enhanced section 377A write-down measures

4.40 In light of the feedback received, the Government has further considered how the proposed regime will interact with the enhanced write-down measures under revised section 377A of FSMA 2000 introduced through the Financial Services and Markets Act 2023.

4.41 As set out in its May 2022 consultation response on these amendments, the Government noted it expects that the enhanced write-down provisions are most

[24] The new Schedule 2A to FSMA 2000 was inserted by Schedule 6 to the Financial Services Act 2021, and will commence on a date appointed by regulations to be made by HMT in due course.

[25] HM Treasury is currently in the process of implementing the framework of secondary legislation required to bring the GAR into force. This process is being undertaken in close coordination with the FCA, the PRA, the Government of Gibraltar and the Gibraltar Financial Services Commission (GFSC).

likely to be applied to support a failing mid-sized insurer on a temporary basis to facilitate continuity of cover. Separately, the intent of the IRR is to ensure a systemic insurer failure with implications for UK financial stability can be managed safely, in most cases to permanently reorganise the balance sheet and allow the insurer to exit the market in an orderly manner. Therefore, the Government expects that firms in scope of the IRR's pre-resolution planning requirements will not be subject to write-down orders under the enhanced section 377A measures, as the latter provisions are not designed to address the financial stability implications of a systemic insurer failure. Therefore, the two respective regimes are explicitly aimed at managing distinct types of insurer failure scenarios, which are likely to manifest as materially different in practice.

4.42 Further, the Government expects that the PRA's key role within both regimes will ensure these meet their distinct objectives, and that the correct action is taken in a failure scenario. Because the PRA determines whether the FOLTF test under RC 1 has been met and is able to consent (or not) to an application to the court for a write-down order under section 377A, it is able to act as the gatekeeper for both regimes.[26]

4.43 Nevertheless, it is possible that in some limited circumstances the IRR and enhanced section 377A write-down powers may interact, or overlap, in a failure scenario. The Government is aware that the FOLTF test under RC 1 of the IRR might be met at an earlier point to the test for a write-down to be ordered by the court under revised section 377A.[27] For example, an insurer could be judged by the PRA to have met RC 1 while remaining able to pay its debts as they fall due, given the scope for the PRA to determine that RC 1 has been satisfied against the narrower section 377A tests as assessed by the court. This means that both regimes could, theoretically, be deployable until the Bank judges, in consultation with the relevant authorities, that the failing firm has also met RCs 2-4 (in which case, the IRR would apply rather than a section 377A write-down).

4.44 The Government considers there to be a theoretical, though unlikely, possibility wherein a write-down order by the court has been made, but a material change in circumstances indicates the section 377A measures might be insufficient to stabilise the firm or the wider financial system. For example, the financial situation of a firm might deteriorate rapidly due to market or macroeconomic events which supersede the effects of the write-down order. To manage such a circumstance, the Government judges it is appropriate to introduce a provision ensuring a firm can be placed in resolution after a court-ordered write-down to account for potential material changes in the wider financial stability context following the making of a court order.

4.45 Therefore, the Government intends to amend new section 377H(2) of FSMA 2000, specifically adding resolution action taken by the RA to the list of revocation events following which a write-down order ceases to have effect.[28] If the RA

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[26] Please refer to section 377C of FSMA 2000 for further detail concerning the PRA's role in applying for a write-down order, or PRA provision of consent in relation to write-down order applications submitted by other eligible parties.

[27] Under revised Section 377A(2), the test which the court must be satisfied is met before a write-down is ordered is: (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.

[28] Please refer to the table of revocation events in section 377(H) of FSMA 2000.

determines that RCs 2 – 4 are met, the provision will allow for the write-down order to cease to have effect upon the date at which resolution action is taken by the RA (except insofar as otherwise specified by the RA in the resolution instrument).

4.46 The Government does not consider that an equivalent mechanism is required to enable an insurer to move from resolution into a court-ordered write-down under section 377A. This is because it is extremely unlikely that, where the PRA and Bank judge that RCs 1 – 4 have been met, an insurer failure would be appropriately resolved through the enhanced section 377A powers. In such a scenario, had there been any reasonable possibility that the enhanced section 377A powers might have promoted better outcomes for the failed firm and its creditors, the RA would have determined that RC 2 was not met.

MREL

4.47 The Government agrees that the introduction of a minimum requirement for own funds and eligible liabilities (MREL) or equivalent under the IRR would be disproportionate, given the objectives of the bail-in tool under the IRR. Therefore, as set out at consultation, the Government will not be introducing MREL or an equivalent requirement into the IRR.

Role of the FSCS under the bail-in stabilisation option

4.48 In line with views expressed by respondents, the Government's proposal to provide FSCS protected policyholders with top-up payments following a bail-in remains unchanged, ensuring eligible policyholders do not suffer net reductions in benefits where individual claims crystallise following a write-down, except to the extent of any existing limit on FSCS coverage.

4.49 On the FSCS's operational capacity to implement the proposals, similar changes have already been made to enhance the existing section 377A write-down powers through the Financial Services and Markets Act 2023.[29] Under these provisions, the FSCS must provide top-up payments to the insurer for onward distribution to eligible claimants with a protected claim following a write-down of liabilities under their policy. It is intended that the FSCS is also provided with a right of recovery against the insurer in respect of these top-up payments.[30] The IRR aims to deliver the same policy intent. HM Treasury and the Bank liaised extensively with the FSCS on these proposals during the initial policy design phase, and are confident that these changes can be operationalised for both the revised section 377A provisions and the IRR.

4.50 The Government wishes to note the proposals under the bail-in option seek to promote continuity of cover. By writing down policy values following a bail-in, the Government is neither proposing to compensate affected policyholders through cash payments or transfer policyholders to another insurer. Instead, the provision of FSCS top-up payments to eligible policyholders will ensure that these policyholders benefit from continued coverage without net reductions in benefits where claims fall due, though the Government notes this is subject to 90% FSCS protection in parts of the non-life sector.[31] Further, under certain circumstances the

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[29] These provisions are in new section 217ZA FSMA 2000 as inserted by the Financial Services and Markets Act 2023.

[30] Please refer to Section 217ZB(1) FSMA 2000.

[31] Please refer to Section 17 of Policyholder Protection in the PRA Rulebook.

PRA rules require the FSCS to secure continuity for policyholders where it is reasonably practicable to do so. Therefore, the Government's proposals seek to promote continued policy coverage following a bail-in, in line with existing FSCS objectives.

4.51 The Government can confirm that the write-down, and any subsequent FSCS top-up received where a claim falls due, will apply to eligible regular premium policies. The Government is aware of the view that reduced residual policy values would disincentivise protected policyholders from continuing to pay full premiums. However, FSCS top-up payments should incentivise those policyholders with 100% FSCS protection to continue to pay their premiums with no net reduction in benefits. Further, permitting corresponding reductions in policyholders' premium payments would be disadvantageous for a firm's balance sheet solvency, likely reducing the effectiveness of the write-down. Where policyholders are 90% FSCS-protected or unprotected, the Government expects that these policyholders will be able to cancel their contract in respect of the unexpired period and seek alternative cover if this is preferable. Depending on the timing of cancellation or surrender, these policyholders may have a claim for a pro rata return of their premium in respect of the unexpired period if they have paid up front.

4.52 With regards to the application of a bail-in to floating charge holders, the Government can clarify that secured creditors will be excluded from the scope of the write-down where they hold a fixed charge or a financial collateral arrangement. In the case of inwards reinsurance creditors (cedants) where their charge, as created, was a floating charge, they will remain in scope of the write-down, though the creditor hierarchy will continue to apply to the extent that the scope of the charge means they rank alongside direct policyholders.

4.53 The Government judges that this position recognises the distinct treatment of fixed and floating charge-holders in winding-up, and will avoid creating an unintended priority for certain cedants. This is because inward reinsurance creditors are often granted a floating charge but contractually subordinated to rank alongside direct policyholders (who have a statutory priority under the creditor hierarchy).[32] If all secured creditors (including the holders of these subordinated floating charges) were excluded from write-down, cedants would be treated more favourably than direct policyholders, contrary to the commercial intent and effect in insolvency. The Government notes that the same policy decision was taken for the enhanced section 377A write-down powers.[33] It should be noted that the creditor hierarchy will continue to be respected, with the effect that ordinary (unsubordinated) floating charge holders will not be written-down until lower-ranking claims (including the claims of direct policyholders) have been fully written down.

4.54 Some respondents highlighted potential for adverse tax consequences to be levied against policyholders receiving FSCS top-up payments. The Government intends to remedy adverse tax implications swiftly and proportionately by providing HM Treasury with powers to make provision relating to the tax implications of exercise of the stabilisation options and tools, allowing resolution

[32] Please refer to the Insurers (Reorganisation and Winding Up) Regulations 2004 (SI 2004/353).

[33] Please refer to Section 377B(1)(d) FSMA 2000 for the relevant provision with respect to floating charge-holders. See also paragraph 3.21 of the Insurer Insolvency Amendments Consultation Response Document.

action to be deployed as intended without creating unwanted tax consequences. These powers will mirror Section 74(2) of the Banking Act 2009, and have also been included in the expanded CCP regime as set out in Schedule 11 Paragraph 105 of the Financial Services and Markets Act 2023, ensuring a consistent approach to tax consequentials is taken across all of the UK's resolution regimes.

Proposed treatment of shareholders under the bail-in stabilisation option

4.55 In line with the KAs, the Government agrees that under the bail-in option shareholders should absorb losses before creditors, including subordinated debt holders, are written down. This aligns with the existing bail-in stabilisation option in the banking regime. Given that use of the bail-in option must reduce or convert all or parts of (largely) unsecured creditor claims in a manner that generally respects the hierarchy of claims in liquidation, the Government intends for relevant legislation to set out the statutory order in which shareholders and creditors would bear losses in a bail-in resolution scenario, in line with the established creditor hierarchy.

4.56 When determining whether eligible liabilities are to be written down or converted in a manner that respects the hierarchy of claims in liquidation, the Government wishes to reaffirm the principle that, as a general rule, the RA should not, when exercising the bail-in option, reduce or convert one class of liabilities while a class of liabilities that is subordinated to that class (and not excluded from the scope of bail-in) remains unconverted or not written down.

4.57 The Government wishes to confirm that a write-down of creditors following a bail-in will be limited to unsecured creditors, except for secured creditors where their charge, as created, was a floating charge. As discussed in paragraph 4.53, this provision will avoid creating an unintended and inappropriate priority for certain inward reinsurance creditors holding a subordinated floating charge ranking *pari passu* with direct policyholders.

4.58 For the bail-in option to be effective, the Government considers that relevant contracts governed by non-UK law should include bail-in recognition clauses. These clauses will ensure that a creditor or party to a non-UK law governed liability otherwise in scope of the bail-in power recognises that the liability may be subject to the exercise of a stabilisation power by the RA, and will therefore be bound by the conversion or cancellation effected by the exercise of the bail-in power. In this respect, bail-in recognition clauses will help ensure that otherwise in scope non-UK law governed liabilities can be written down or converted by the RA, making the option effective.

4.59 To ensure a proportionate approach, the Government intends to devise the precise nature and scope of the requirements for bail-in recognition clauses in line with the following:

- Firms will not be required or expected to take any action to introduce bail-in recognition clauses for non-UK law governed contracts until both the primary legislation for IRR has been enacted and is in force and the Bank or the PRA has issued the appropriate guidance setting out the principles referred to below;

- The Bank and the PRA will develop principles defining the scope of the bail-in recognition clause requirements, likely with reference to both the attributes of the firm creating the liability and the type of contract or contractual liability;

- Unlike bail-in recognition clauses for banking firms, the Government does not expect the scope of relevant contracts incorporating bail-in recognition clauses to include all third-country law governed liabilities incurred by UK insurance and reinsurance firms (and holding companies), as the Government judges that such an all-encompassing approach would be disproportionate given the share of UK insurers' (and their holding companies') relevant contracts that are non-UK law governed;

- Like the regime for banking firms, it is intended that the requirement to include a bail-in recognition clause in any individual contract will be subject to an exception for where inclusion is impracticable;[34]

- The requirements will be "grandfathered", meaning that pre-existing contracts which would otherwise sit in scope of bail-in recognition clauses will be exempted from the requirement unless and until they are materially amended after the date on which the requirement for recognition clauses comes into effect.

4.60 Separately, but for similar reasons, the Government has determined that another type of contractual recognition clause will be required. These clauses are to be included in certain non-UK law governed "financial contracts" in order for the restrictions on termination rights and policyholder surrender rights set out in paragraphs A.98 to A.100 of the consultation to be as effective as possible.[35] As set out in paragraph A.103 of the consultation, set-off, netting and title transfer arrangements will be protected. Again, the Bank and the PRA will develop a set of principles to define the precise nature and scope of this "stays" recognition clause requirement, and transitional provisions to grandfather pre-existing contracts will be included.

4.61 With respect to when bail-in should be executed, the Government agrees with the large number of respondents who suggested it would be desirable to provide the RA with flexibility as to when a bail-in is executed against, for instance, the residual equity of a firm. The Government agrees that a flexible rather than prescriptive approach will ensure the RA can respond to live circumstances as most appropriate to meet the statutory Resolution Objectives. In particular, the Government maintains its view, as proposed in paragraph A.55 of the consultation, that the PRA could judge RC 1 to be met while an insurer still retained residual book value, given the potential for a range of failure scenarios.

4.62 As set out in paragraph A.56 of the consultation, the Government considers the most effective route to ensuring appropriate outcomes between shareholders and creditors is to use the set of pre-resolution valuations to calculate the amount of capital needed to support a solvent run-off, and in so doing, the required size of the percentage write-down of creditors. This process will also provide an estimate of the relevant insolvency counterfactual to consider against the value of

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[34] See PRA Rulebook, Contractual Recognition of Bail-in.

[35] "Financial contracts" are defined in the EU Banking Resolution and Recovery Directive (BRRD) Article 1(1) (100), and covers a broad range of securities and commodities trading contracts and derivatives agreements.

shareholders' existing equity. Where the percentage write-down of liabilities based on a provisional valuation undertaken by the Bank exceeds requirements when assessed against the subsequent independent valuation, it is appropriate for the RA to possess a write-up power to correct the excess write-down.

Pre-resolution valuation and NCWO compensation

4.63 As set out in the consultation, the Government can confirm that the regime will incorporate two distinct valuation processes. Firstly, as set out in paragraph 2.18 of the consultation, a set of pre-resolution valuations will be required before the RA exercises any of the stabilisation options. Collectively, these valuations will inform the RA's decision as to whether the RCs have been met and, if so, which stabilisation options and other tools should be deployed and how they should be exercised. Secondly, following resolution, HM Treasury would appoint an independent valuer to conduct an independent valuation to determine the level of NCWO compensation, if any, which would need to be paid to the resolved firm's creditors and/or shareholders.

Pre-resolution valuation

4.64 The Government judges that to ensure the actuarial estimations incorporated are sufficiently prudent and focused, it is appropriate to incorporate in legislation high-level principles for the set of pre-resolution valuations. Subsequent to these principles, the Government intends to set out further detailed pre-resolution valuation standards and rules, and intends to provide further information on the approach that will be taken in due course. The Government considers it likely that pre-resolution valuations will be based on a failing or failed firm's latest reported (and audited) position, rolled forward with relevant modifications (including to reflect market conditions prevailing at the point of resolution) to assess the various impacts of the prospective actions that the RA could take under the stabilisation options.

Independent valuation and NCWO compensation

4.65 Regarding the independent valuation for establishing whether NCWO compensation is required, and from and to whom, the Government notes the actuarial challenges in assessing future claims. As noted by respondents, these technical challenges reflect the fluid and contingent value of policyholder liabilities and the potential for market disruption when a valuation is required.

4.66 Nevertheless, resolution calls for timely and decisive action. Accordingly, the Government can confirm that the regime will use a definitive point-in-time independent valuation to determine whether NCWO compensation needs to be paid following resolution action, and to whom. This aligns with the existing valuation frameworks in both the banking and CCP resolution contexts. As set out in paragraph A.80 of the consultation, the Government will reserve the right to specify the appropriate principles for the independent valuer to apply in determining the level of NCWO compensation required, if any. This will ensure that the correct information and data is captured to construct an insolvency counterfactual sufficiently robust to anchor an evaluation of whether NCWO compensation is required (and, if so, in what amount).[36] The Government considers that a definitive point-in-time approach is more workable than continuous assessments or valuation ranges.

4.67 In light of further feedback from respondents, the Government has further considered the overarching principle for effecting NCWO compensation against the contents of international standards. The Government judges that the NCWO safeguard should seek to ensure that policyholders and other creditors receive no less favourable treatment than they would have received had the insurer entered insolvency.

4.68 The Government wishes to note that there is no provision in Part VII FSMA 2000 specifying that policyholders must not be left materially worse off following a court-ordered transfer scheme. Rather, the court must consider that, in all the circumstances of the case, it is appropriate to sanction the transfer.[37] Whether or not specific individual policyholders are materially worse off following a court-ordered transfer scheme would not be likely, in isolation, to determine the merit of a transfer scheme. Individual policyholders considering themselves materially worse off following a court-ordered Part VII transfer can make representations to the court as appropriate. Therefore, the Government does not consider that this provides an appropriate precedent for assessing an entitlement to NCWO compensation.

4.69 The Government judges that, in order for the safeguard to function in a robust and timely manner, different principles might assess NCWO compensation claims for different groups of similarly situated policyholders, while reserving margins of judgment to the independent valuer. In this respect, the Government considers that an appropriate set of valuation standards should allow the valuer to identify such groups. However, compensation would be provided to creditors on an individual basis.

4.70 The position of with-profits policyholders within the NCWO compensation framework has also been considered further by the Government, particularly in relation to a private sector transfer or transfer from a bridge to an acquiring firm. In the resolution of a life insurer with a significant with-profits fund, the Government notes that the RA may convert with-profit policies into unit-linked policies. This action would produce more equitable outcomes between different sets of policyholders in the failed and acquiring firms. The Government considers that this approach is also justified by the NCWO safeguard because the FSCS does not guarantee profits under a with-profits policy unless and until declared, meaning that with-profits policyholders would not be worse off than under the insolvency counterfactual merely because of their conversion to unit-linked policies.

4.71 The Government can also confirm that an *ex post* independent valuation for the purposes of determining NCWO compensation due, if any, will only take place following the use of the partial transfer (whether to a private sector purchaser or bridge institution) or bail-in stabilisation options.

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[36] The insolvency counterfactual would likely consist of winding up scenarios where no stop order has been made, a stop order has been made, or both.

[37] Please refer to section 111(3) of FSMA 2000.

Pre-resolution planning

4.72 As set out in international standards, pre-resolution planning is defined as the national resolution authorities' responsibility to develop firm-level Resolution and Recovery Plans and conduct Resolvability Assessments.[38]

4.73 The Government agrees with views expressed by respondents that it is appropriate for systemically significant UK-headed insurers to engage with the RA on its pre-resolution planning under the regime, ensuring the regime aligns with the relevant international standards.[39] Similarly, the Government also wishes to note its agreement that the RA's approach to pre-resolution planning must be proportionate to the systemic risks posed by a given insurer in scope of the requirements.

4.74 As set out in paragraph A.86 of the consultation, the Government agrees that minimising duplication of activities respectively undertaken by the PRA and the Bank will be important to implementing a proportionate regime. In this respect, the Government intends to ensure that information and data provided by firms to the PRA under exit planning and general supervisory arrangements can be leveraged by the RA to deliver its pre-resolution planning requirements. This should minimise duplication and the resource burdens placed on the firms in scope of both regimes. In the wider planning context, the Government is also conscious of the PRA's new priorities for its exit planning regime, including its upcoming consultation on requirements for insurers to prepare proportionate exit plans commensurate with the size and complexity of the insurer.[40] The Government's intent is for the RA's pre-resolution requirements to reflect the PRA's additional activities in this space, and only request that firms provide further information and data where these provide proportionate benefits for planning firms' resolution under the IRR.

4.75 Further guidance on the information and data required from firms to develop pre-resolution plans, and how this interacts with existing PRA requirements, will be set out in due course. Similarly, the Bank also intends to provide further guidance on its proposed approach to Resolvability Assessments, particularly the role firms will play in their development and delivery.

4.76 Finally, the Government agrees that firm action to remedy barriers to resolvability, as directed by the RA, should have regard to the potential impact of the required action on the firm in question, the wider financial services market and financial stability in the UK. This aligns with the equivalent power under the banking regime.[41]

Ancillary powers

Stay on policyholders' surrender and switching rights

4.77 Certain life insurance policies include an investment element and accrue value over time. These policies typically include 'surrender' clauses allowing policyholders to partially or fully terminate their contract before maturity in return

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[38] Please refer to KAs 10 (Resolvability Assessments) and 11 (Recovery and Resolution Planning).

[39] Please refer to KA 11.

[40] Please refer to the PRA's open letter to firm executives on its [2023 priorities for insurance supervision](#).

[41] The Government's intention is to mirror section 7A of the Banking Act 2009.

for its cash value. Switching rights allow policyholders of unit-linked products to switch their investments from one fund to another, within one plan.

4.78 The Government agrees with respondents' broad support for the RA to have the power to impose temporary restrictions on policyholder surrender and switching rights under the proposed regime, where applicable.[42] These restrictions would be aimed at mitigating the risk that policyholders, *en masse*, surrender eligible contracts over concern that they will lose value following a firm's entry into resolution, given that policyholders are generally able to convert their accrued policy value to cash at will, or switch between different funds in order to reduce investment exposure. Temporary restrictions on policyholders' surrender and switching rights are mandated under relevant international standards.[43] Under the banking regime, analogous provisions are included under section 70A of the Banking Act 2009, which the RA has the discretion to impose when exercising a stabilisation power.[44]

4.79 In an insurance context, comparable measures have recently been introduced through the Financial Services and Markets Act 2023, where an insurer is judged to be in financial difficulties by the court.[45] There are three features of these provisions which are worth flagging. First, the restriction lasts for an initial 6-month period in the event of a write-down order, with the possibility of extension if granted by the court (the period can also be reduced in various circumstances). Second, the restriction prevents certain life insurance policyholders from surrendering their policies, although small withdrawals (or 'partial surrenders'), of up to 5% of the value of the policy in any 12-month period, will still be permitted, so as not to restrict regular partial surrenders potentially serving as income. The Act also provides HM Treasury with a power to amend this percentage limit.[46] Third, the provisions make available individual hardship exemptions where the stay would otherwise be likely to cause hardship to policyholders.

4.80 However, the Government wishes to note that the temporary restriction on policyholder surrender and switching rights under the IRR will operate in different ways to the provisions in new Schedule 19C FSMA 2000. These differences are set out below:

- The temporary stay on surrender and switching rights included in the IRR will not operate automatically, unlike the Schedule 19C FSMA 2000 provisions.[47] Rather, the RA will be given the discretion to operate this

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[42] Surrender rights are applicable to both unit-linked and with-profits policies.

[43] Please refer to section 12.7.4 of the IAIS's Insurance Core Principles (2019) for a non-exhaustive list of powers mandated under international standards, including the power to restrict or suspend the policyholders' rights of withdrawing their insurance contracts.

[44] The provisions under section 70A of the Banking Act 2009 allow for the RA to temporarily suspend obligations to make a payment, or delivery, under a contract where one of the parties to the contract is a bank in respect of which the Bank is exercising a stabilisation power.

[45] As set out in Schedule 19C FSMA 2000, an insurer is judged to be in "financial difficulties" for the purposes of the restriction on surrender rights if the insurer is under a court-ordered write-down, in or awaiting administration, or subject to a winding up petition.

[46] Please refer to paragraph 12 of Schedule 19C FSMA 2000.

[47] This restriction on surrender rights operates automatically, with a default scope and period which can be adjusted manually by court order, where an insurer is judged by a court to be in financial difficulties (as defined above).

restriction in line with financial stability risks, which the Government judges to be a more proportionate and pragmatic approach.

- Unlike the automatic 6-month restriction in the Schedule 19C FSMA 2000 provisions, the Government agrees with respondents that the appropriate length will be challenging to determine *ex ante*. This is because the optimal stay period in a particular failure scenario is likely to depend on the factors determining that resolution action is required and what the objective of the resolution action is, or is likely to be. Therefore, it is appropriate for the initial length of the stay, if required, to be determined by the RA at the point of resolution (i.e., rather than being set out in legislation). The RA would be required to consult the FCA on the initial length of the stay and any subsequent extensions, given the consumer protection implications.
- The hardship exemption envisaged by the Government is intended to broadly mirror the intent of Schedule 19C FSMA 2000. In particular, the Government expects that the RA or resolved firm (with RA oversight) would be able to provide consent for the surrender of an amount that would exceed the surrender limit for the relevant period.[48]

4.81 The Government intends to consider further whether these temporary restrictions could create additional tax consequences for relevant policyholders. As described in paragraph 4.54, the tax consequentials power will allow the Government to remedy issues related to use of these restrictions upon implementation of the regime.

Other ancillary powers

4.82 The Government agrees with respondents' broad support for the proposed ancillary powers, which will help the RA deliver an orderly and effective resolution. The Government can confirm it intends to provide the RA with the ancillary powers as set out in international standards and paragraph A.103 of the consultation.[49]

4.83 In line with international guidance, the Government agrees with respondents that these powers should be deployed in a targeted manner, and wishes to reaffirm its intention that these provisions are exercised in a proportionate way that resolves the insurer most effectively in light of the circumstances of the specific resolution and Resolution Objectives.

4.84 As set out in paragraphs 4.58 to 4.60, the Government intends to introduce requirements concerning contractual recognition clauses supporting bail-in and the stays for policyholder surrender rights and *ipso facto* termination rights for certain non-UK law governed contracts.

4.85 The Government has considered whether the ancillary powers set out could be made more effective by enabling the Bank to provide liquidity support to an insurer with immediate liquidity issues under the ancillary powers framework. However, the Government's view is that provision in legislation is not needed to achieve this.

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[48] This largely reflects the parties listed in paragraph 5(1) and (2) of Schedule 19C FSMA 2000.

[49] Please refer to section 12.7.4 of the IAIS's Insurance Core Principles (2019) for a non-exhaustive list of ancillary powers mandated under international standards.

Lead-in time

4.86 The Government will continue to consider the prevailing view expressed by most respondents that a minimum of 12 months lead-in time is likely to be necessary for firms to implement any requirements mandated under the regime. Further, the Government appreciates that implementation timelines are likely to depend on the scope of pre-resolution planning mandated by the RA and how prepared firms of various sizes, business models and risk portfolios are to deliver this.

4.87 The Government will provide more detailed information on implementation timings when appropriate. While the Government recognises that it is important to ensure that the Bank has the powers and tools required to operate the regime as soon as possible, it also agrees that industry should be provided with a reasonable lead-in time to make any changes required.

Costs for industry

4.88 In line with its objective to introduce a proportionate regime, the Government will continue to consider any significant costs the introduction of the IRR might impose on firms. To this end, the Government intends to undertake a Regulatory Impact Assessment (RIA) to evaluate the costs and benefits of the proposed regime in due course, most likely to accompany the legislation implementing the regime upon its introduction to Parliament.[50] The RIA would capture a range of potential costs to industry, including those raised by respondents, such as administrative and/or resource-based costs and legal costs.

4.89 The Government notes it conducted a full RIA before introducing the Financial Services and Markets Act 2023 to Parliament, enhancements to the section 377A write-down power and moratorium on termination rights introduced via new Schedule 19C FSMA 2000.[51]

Further issues raised by respondents

4.90 Points raised by respondents in response to Question 14 touched on a variety of themes and proposals. A number of these issues were raised in relation to other consultation questions and were discussed in the relevant section of the response, and this is noted below where appropriate. Where respondents raised new issues in response to this question, these have been sub-headed to organise the Government's response to each theme or proposal raised.

UK branches of foreign insurers

4.91 Please see the Government's response as set out in paragraphs 4.11 to 4.18.

Application of the regime to group entities

4.92 Please see the Government's response as set out in paragraphs 4.19 to 4.23.

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[50] Regulatory Impact Assessments set out the objectives of policy proposals and the costs, benefits and risks of different ways (non-regulatory as well as regulatory) of achieving those objectives.

[51] Please refer to the "Insurers in Financial Difficulties" section of the Government's Impact Assessment for the Financial Services and Markets Act 2023: https://bills.parliament.uk/publications/49053/documents/2621

Pre-resolution ‘provisional’ valuation

4.93 The provisional valuation will form part of the set of pre-resolution valuations, and is intended to determine the appropriate option(s) for resolution action. If required, the Government agrees that it could be challenging for the RA to conduct a provisional valuation to short timelines with sufficient precision to prudently evaluate the assets and liabilities of an insurer. Therefore, the Government considers it likely that the RA will need to conduct a provisional valuation based on key assumptions and other sensitivities. However, the Government considers that this will be sufficient to inform the determination as to whether the conditions for the exercise of stabilisation powers are satisfied and the appropriate option(s) for resolution action, which are the principal purposes of a provisional valuation. In this respect, the Government judges it is appropriate to incorporate assumptions and other sensitivities in order to facilitate action at pace, particularly where a delay in acting might have implications for financial stability.

4.94 Relatedly, this does not exempt the RA from appointing an independent valuer to conduct a ‘full’ valuation at a specific point in time following resolution, and the RA could make supplemental provisions to the resolution approach taken if these valuations differed.

4.95 The Government agrees that insurance policies, particularly in the life sector, are often subject to significant assumptions and fluctuations. In this respect, the Government acknowledges the scope for litigation action to be taken by policyholders and other creditors following resolution. However, the Government judges that the NCWO safeguard, as mandated under international standards, will provide a robust and effective basis for compensating creditors where they receive less favourable treatment than they would otherwise have done in insolvency, subject to certain assumptions about the operation and effect of that counterfactual. The Government also intends to enact provisions, equivalent to the banking regime, preventing the court invalidating actions taken by the RA and limiting court powers in respect of judicial review following the exercise of the stabilisation options.[52]

Private sector transfer option

4.96 The Government has considered the scope for the transfer of a resolved insurer to a willing and able acquirer, either via private sector transfer or onwards transfer from a bridge, to interact with competition rules. The Government expects that the Competition and Markets Authority (CMA) will retain its usual role in reviewing any transfer that might have implications for competition in the sector and, where appropriate, would propose subsequent remedies in line with its mandate to promote competition. However, under the banking regime, the CMA also considers whether the public interest, on the grounds of protecting UK financial stability, is served by effecting the transfer. The Government expects that a similar approach, and set of considerations related to the public interest, would be taken under the proposed IRR.

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[52] Please refer to Article 186 of the Bank Recovery and Resolution (No. 2) Order 2014: https://www.legislation.gov.uk/uksi/2014/3348/article/186

Bridge insurer option

4.97 The Government considers there to be a number of potential benefits that the bridge stabilisation option might offer against either a private sector transfer or placing a firm into run-off without exercise of the stabilisation powers. First, without a bridge insurer option, the private sector transfer option is limited to viability only when there is a willing and able acquirer at the point of resolution. In particular, the absence of a bridge may make any transfer option unviable in resolution scenarios where, for example, there is market-wide stress affecting prospective acquirers. Second, the bridge could be deployed to house commercially viable business of the firm in resolution (and therefore meets the capital requirements for safe run-off), while an acquirer is found or while an acquirer completes due diligence checks. Relatedly, the bridge insurer option could also be used to clean up a failed insurer and preserve good assets to take value to the market, and ensure a further entity for winding down a 'bad book' of business can be created in a safe manner (potentially through a further transfer of business to a balance sheet management vehicle (BSMV)).

4.98 As set out in paragraph A.37 of the consultation, the Government can confirm that the RA will be empowered to make an onward transfer instrument with court approval, allowing the RA to transfer either the shares or business (in part or full) out of the bridge to a willing private sector purchaser (or to a further entity, such as a BSMV). Before making an onward transfer, the RA will be required to consult with the PRA, FCA and HM Treasury. This requirement for the RA to consult HM Treasury, as well as the regulators, extends to all onwards transfers, rather than instances where a transfer might present risks to public funds. This ensures the relevant public authorities take a rounded collective view of any transfer out of the bridge vehicle.

Bail-in option: pay-as-paid clauses

4.99 Regarding the Government's proposals to override pay-as-paid clauses following use of the bail-in option, the Government considers that failure to override such clauses would present undue financial benefits to a reinsurer once a cedant had been bailed in. With respect to whether the reinsurer's risk would be unjustly amplified, the Government's view is that the relevant counterfactual is instructive. Specifically, were the bail-in of an insurer required to recapitalise an insurer to enable the firm to meet the conditions for solvent run-off, it is highly likely that the relevant counterfactual would be entry into insolvency procedures, wherein reinsurers cannot use 'pay-as-paid' to reduce their liability to the cedant by reference to a reduction in payments to underlying policyholders.[53] As such, replicating this effect following use of the bail-in option is unlikely to increase the risk of loss for reinsurers against the relevant counterfactual. This principle aligns with the enhanced section 377A FSMA 2000 powers.[54]

Temporary public ownership

4.100 In line with the KAs, the Government can confirm that the IRR will include a last resort option to place a failing entity into temporary public ownership, if required to meet the overarching purpose of maintaining financial stability. To

[53] Please refer to Charter Reinsurance Co Ltd (In Liquidation) v Fagan [1997] A.C. 313.

[54] Please refer to paragraph 10 of Schedule 12 of the Financial Services and Markets Act 2023.

reflect the extreme and highly unlikely circumstances in which such action would be required, HM Treasury would need to determine that one of two further conditions had been met.[55]

Other legal issues arising through use of the stabilisation options

4.101 The Government is continuing to consider whether the RA and/or the regulators should have any additional powers or make amendments to specific aspects of the regulatory regime to support the aims of the IRR whilst firms are in resolution. Such powers and tools would allow the RA and the regulators to address circumstances where wider regulatory requirements risked undermining or inhibiting the RA's resolution strategy. For example, it might be appropriate to establish a bridge insurer with capital requirements and threshold conditions recognising the purpose of that entity at the point of authorisation and on a continuing basis.

Ancillary powers

4.102 The RA will be empowered to amend existing court-approved schemes that may operate within the failed transferor's business. Including this power within the ancillary framework ensures minimal scope for inequitable treatment between specific groups of creditors in the failed and receiving firm, such as with-profits policyholders, and aligns with the statutory Resolution Objectives. The Government intends for this power to be set out in legislation.

Funding the regime

4.103 As set out in the consultation, the Government has sought to design the IRR in a proportionate manner that does not levy significant costs on the insurance sector. This ambition has informed some fundamental policy choices within the regime, including the Government's decision not to propose the introduction of MREL or "bail-in bonds". To finance the RA's use of the bail-in option, for instance, the Government considers that the FSCS is well-placed to provide top-up payments to protected policyholders subject to usual FSCS eligibility criteria and compensation limits.

4.104 As detailed in paragraph A.54 of the consultation, the Government intends to legislate for a mechanism to provide for payments to be made in cash, funded by cash-flows derived from the holding or disposal of shares in a failed firm or its holding company to the FSCS in relation to top-up payments it has made, and to unprotected policyholders and other written down creditors with crystallised claims against the bailed-in firm. The Government intends to legislate to provide the RA with the power to establish the compensation mechanism after the RA has bailed-in a firm to the extent that policyholders are written down, given that exercise of this option (and subsequent write-down of creditors beyond shareholders and subordinated debtholders in line with the established hierarchy of claims) is the only stabilisation option where an additional funding consideration will apply. This mechanism is intended to assist HM Treasury and the RA in meeting their statutory objective to protect all written down policyholders and creditors in resolution, including those not protected by the FSCS.

[55] These two further conditions are set out in paragraph A.63 of the consultation.

4.105 In line with the precedent established under the Banking Act 2009, the Government considers it appropriate for the RA to direct a relevant insurer to pay the Bank of England and/or HM Treasury a fee to cover expenses reasonably incurred by the Bank in connection with exercising the resolution option(s).[56] These costs are likely to extend to the services which the Bank must procure in relation to exercising the stabilisation options, such as conducting pre-resolution and independent valuations.

[56] Please refer to section 48WA of the Banking Act 2009. In line with section 48WA, a 'relevant insurer' is defined as an insurer in relation to which the Bank has made a resolution instrument or an instrument including bail-in provisions.

Chapter 5

Next Steps

5.1 Some respondents asked for clarity on when the Government would legislate and implement the expanded regime, and whether the Government had plans to consult with industry further on any aspects of the regime.

5.2 The Government plans to legislate when parliamentary time allows and will set out further information on plans in due course. It is the Government's intention that, once any legislation is passed, the stabilisation options and tools and ancillary powers will be made available for the Bank as soon as practicable. However, the Government and the Bank will aim to ensure industry is given sufficient time and notice to make any necessary changes to accommodate these new powers. The Government and the Bank will therefore seek to work closely with industry as its legislative plans and timings develop to support them to do this.

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This document can be downloaded from www.gov.uk

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