

Feedback Statement to HM Treasury Consultation on Insurers' (Reorganisation and Winding-Up) (Lloyd's) Regulations 2005

Introduction

1. The Insurers Reorganisation and Winding-Up Directive (2001/17/EC) creates rules at the EU level with regard to insurance undertakings that are subject to reorganisation measures or winding-up proceedings. The Directive provides that these measures or proceedings may be established or opened only in the home Member State of an insurance undertaking and that those measures or proceedings will be recognised and have effect throughout the EU.

2. The principle purposes of the Directive are:

- To simplify proceedings when an EU insurance undertaking is in financial difficulties, enabling efficient reorganisation or distribution of assets;
- To co-ordinate reorganisation and winding-up arrangements across Member States through mutual recognition; and
- To ensure that all EU creditors are treated equally.

3. The Directive was implemented in respect of all other insurers in the UK by the Insurers (Reorganisation and Winding-up) Regulations 2003 and 2004. The Government needs to make provision in relation to the Lloyd's market that will have an equivalent effect to the Regulations governing all other insurance undertakings, so far as that is possible given the particular characteristics of the Lloyd's market.

4. Reorganisation measures and winding-up or bankruptcy procedures already apply to persons who are members of Lloyd's under the general law. By contrast, there is no legal mechanism for the co-ordinated application of reorganisation measures and winding-up procedures to the Lloyd's market as a whole. The regulated 'insurance undertaking' for the purposes of the insurance directives, the "association of underwriters known as Lloyd's", has

no legal personality in any other context and has no legal status in the UK.

5. In implementing the Winding-up Directive in relation to Lloyd's, the Government also has to have regard to the Insolvency Regulation¹. Both the Insolvency Regulation and the Directive are intended to deal with the cross-border effects of insolvency proceedings in the European Economic Area. The intention is that there should be a single set of rules for determining which State has jurisdiction in insolvency matters, and therefore which insolvency law applies, affecting both persons and businesses where assets or liabilities are present in more than one Member State. The Insolvency Regulation applies to all businesses and individuals in the EU, with the exception of insurance undertakings, certain investment undertakings and credit institutions. In Community law terms, that means the Regulation does not apply to "the association of underwriters known as Lloyd's". But, on the face of it, the Regulation does seem to apply to the underwriting members considered individually (as the members are not themselves insurance undertakings).

6. For the UK to implement the Winding-up Directive effectively in relation to the Lloyd's market, it is therefore necessary to provide that in certain circumstances the reorganisation or insolvency of an underwriting member is to be treated as falling within the ambit of the Winding-up Directive and not the Insolvency Regulation. The effect of the provision in the proposed regulations outlined further below will be that a member is to be treated as if it is a UK insurer for the purposes of the Insurers (Reorganisation and Winding Up) Regulations 2004 and, in the case of a member that is a company, the Financial Services and Markets Act 2000 (Administration Orders Relating to Insurers) Order 2002 (as amended) if the following conditions are met.

- the Lloyd's market does not meet its regulatory solvency test;
- a Lloyd's market reorganisation order is in force;
- the member is not excluded from that order;
- the court is not satisfied that it is likely that the insurance market debts of the member will be satisfied.

¹ Council Regulation (EC) No. 1346/2000 of 29 May 2000 on Insolvency Procedures" OJ. L. 160, 30.6.2000, p.1.

In such a case reorganisation measures and winding up proceedings must be operated according to the 2004 Regulations as adapted by these Regulations.

Consultation

7. This feedback statement relates to the proposed measures laid out in HM Treasury's consultation document, published in December 2004, entitled *'Implementation of the insurers reorganisation and winding-up directive for Lloyd's – A consultation document'*. The three-month consultation exercise closed on 11 March 2005.

8. The consultation document set out details of the Directive's requirements and HM Treasury's proposed implementation approach, as well as containing the draft Regulations and a Partial Regulatory Impact Assessment.

9. HM Treasury received nine responses from to the consultation. The non-confidential responses received are listed at Annex A.

10. Four of these responses were from natural names or those specifically representing natural names; of these, three did not address the individual questions posed by the consultation document. Rather, they sought clarification on the scope of the Regulations, and the proposal for prioritisation of insurance creditors. None of these three respondents expressed a view generally on the proposals.

11. The other six respondents were broadly supportive of the proposals and provided comments on the specific questions posed in the consultation document.

12. In the light of the consultation responses, four small amendments have been made to the Regulations, two in relation to the role of the reorganisation controller in the event that a Lloyd's Market Reorganisation Order were to be made by the Court, one in relation to the time allowed for drawing up a reorganisation plan, and one to take into account differing insolvency provisions in Scotland.

13. This feedback statement addresses the significant policy issues raised by interested parties.

14. HM Treasury would like to thank all those who responded to the consultation document.

Summary of Responses

Q1. Does 1.21 contain the correct list of people to whom the implementation of the Directive should apply?

- 1.1 Over half the respondents agreed that this list did comprise the appropriate parties.
- 1.2 One respondent queried what the role of a Members' Agent would be within this context and why this category of persons would be subject to the Directive provisions. HM Treasury's response is that, in their capacity as an agent acting on behalf of their principal, that is, the Name, this category is necessarily subject to the Directive provisions.
- 1.3 Certain of the remaining respondents voiced resistance to the proposal that former members of the Society be subject to the requirements of the Regulations. HM Treasury's response is that, given the obligations of the Directive, it is necessary to apply the Regulations to all those parties with ongoing liabilities (crystallised or otherwise) with Lloyd's; this, by definition, extends to former members.
- 1.4 One respondent was of the view that all parties listed, apart from the members and former members, would only ever be subject to the Insolvency Regulation, and that this instrument should not therefore apply to them. HM Treasury's response is that the instrument applies to the persons other than members and former members so that the moratorium on litigation will apply to all persons who hold property either on their own account or for others that might be subject to litigation in an attempt by claimants under insurance policies or others to obtain an advantage as against other claimants. Such persons can seek to be excluded from the order by making an application under regulation 7. It does not

attempt to apply the provisions of the principal Regulations that give effect to the Directive to such persons.

1.5 HM Treasury shall therefore be retaining this approach.

Q2. Are there significant arguments in favour of applying the Directive's provisions directly to the isolated insolvency of particular members of Lloyd's while the assets of the Central Fund are sufficient to ensure that all insurance claims against members are satisfied?

2.1 The unanimous consensus was that HM Treasury's analysis in this respect was the correct one; namely, that the provisions of the Regulations will apply to the association of underwriters known as Lloyd's, only in the event of it being unable to meet its solvency requirement, and that, up until this point, the individual members would be subject only, as is currently the case, to existing insolvency laws.

2.2 HM Treasury shall therefore be retaining this approach.

Q3. Should only the FSA or Society be able to make an application for the Lloyd's market reorganisation order as prescribed in draft regulation 6?

3.1 The unanimous consensus was that this was the correct approach. HM Treasury shall therefore be retaining this regulation as it stands.

3.2 It was pointed out however, and HM Treasury would support the view that, this power on the part of both the FSA and the Society should not be taken as deterring either party from exploring alternative, more appropriate options first.

Q4. Are the objectives of the Lloyd's market reorganisation order, as described in this Consultation document and as prescribed in draft regulation 5, appropriate? Are there other possible objectives, which should be considered?

4.1 The unanimous consensus was that these objectives were appropriate as they were. HM Treasury shall therefore be retaining this regulation as it stands.

4.2 Some concern was voiced regarding the extent to which unlimited liability members would be treated differently by the requirements of the Regulations than limited liability members. HM Treasury's response is that this is necessarily a direct consequence of members' differing legal obligations depending on whether they have or do not have limited liability. The Regulations will consequently treat them in accordance with their existing legal status.

Q5. Is the trigger, as explained in this Consultation document and as prescribed in draft regulation 4, the correct test for making a Lloyd's market reorganisation order?

5.1 The unanimous consensus was that this was the correct test. HM Treasury shall therefore be retaining this regulation as it stands.

Q6. Is it useful to create an officer of the Court, the reorganisation controller and is his role as explained in this Consultation document (and as set out primarily in draft regulations 9, 14-29) suitable?

6.1 The unanimous consensus was that this was a very useful provision. HM Treasury shall therefore be retaining this approach.

6.2 However, concerns were voiced that there existed no mechanism for ensuring that the reorganisation controller would be remunerated, as had been HM Treasury's intention. This omission has now been addressed with the insertion of new regulation 12 ('Remuneration of the reorganisation controller').

6.4 The point was also raised that it could prove unrealistic to expect necessarily to find an insolvency practitioner to undertake the role, who was both suitably qualified and knowledgeable, and appropriately impartial. This was deemed a valid point, given that this is a specialised field, comprising limited numbers of practitioners. This potential difficulty has been solved by the

insertion of new regulation 9 (3), which allows for an application to the Court for the appointment of one *or more* reorganisation controllers.

Q7. Are there any particular comments on the process for the creation of the reorganisation plan as described in this consultation document and as prescribed in draft regulation 11?

7.1 Two respondents asked how it would be possible for the reorganisation controller to enforce his requests for information from the relevant parties. HM Treasury's response is that, as a last resort, the reorganisation controller is able to apply to the Court for an order to be made in respect of a request for information.

7.3 It was also suggested that it might be inappropriate in some circumstances for a syndicate outside the scope of the Lloyd's market reorganisation order to continue making payments on liabilities, given that the Central Fund has already been deemed inadequate. HM Treasury's response is that it is a member or members who can be outside the scope of the order, rather than a syndicate. Second, in the event that a syndicate exhausted or was in danger of exhausting all of its resources, as a result of such a scenario, any members unable to meet their insurance liabilities would be brought within the scope of the Lloyd's market reorganisation order in accordance with the process in regulations 13 and 14 (previously draft regulations 12 and 13).

Q8. Is it the correct approach, once a Lloyd's market reorganisation order has been made, for the same obligations to be imposed on a member as are imposed on all other UK insurers for the purpose of insolvency proceedings unless the court is satisfied that the insurance creditors of that member will be satisfied? This approach is described in the Consultation document and prescribed in draft regulations 12 and 13.

8.1 This was considered a sensible and realistic approach. HM Treasury shall therefore be retaining this approach.

Q9. Our proposed treatment of assets held in trust is explained in this consultation document and set out in draft regulation 39. Does this treatment give rise to difficulties for insurance claimants, managing agents or others?

9.1 This proposal was broadly supported by respondents. HM Treasury shall therefore be retaining this approach.

9.2 In response to one query raised, HM Treasury's response is that the Regulations impose no changes on the status of existing secured or preferred creditors. Rather, insurance creditors are preferred creditors who rank before the general creditors.

Q10. Do consultees agree with our proposed treatment of liabilities, which have undergone the RITC process as described in this consultation document and as provided for in draft regulation 40?

10.1 It was broadly accepted that this treatment was appropriate. HM Treasury shall therefore be retaining this approach.

10.2 Some respondents did raise queries relating to the extent to which Equitas reinsured Names would be affected by, or caught within, the Regulations. By way of clarification, HM Treasury would emphasise that the Directive does *not* apply to reinsurers. Only in the event of a wider market problem in respect of then current members that happened also to extend to Equitas Names, would a Lloyd's market reorganisation order be able to apply the Regulations and the principal Regulations in respect of Equitas reinsured Names as well.

Q11. Do consultees agree that set-off should operate at syndicate level as set out in draft regulation 21?

11.1 The unanimous consensus was that this should certainly be the case. HM Treasury shall therefore be retaining this regulation as it stands.

11.2 Two respondents enquired whether a better method for achieving set-off might be for all underwriting years of account to be combined, rather than considering each individual year in

isolation. HM Treasury's response is that since the membership of syndicates can vary from year to year it was considered that the set-off should continue to operate as provided.

Q.12 Is the potential effect of the limitation on the use set-off so serious in the case of Lloyd's underwriters that it will make the achievement of the objectives set out in regulation 5 significantly more difficult? Are there any other arguments to be considered in this question?

12.1 Two respondents noted that to alter the limits that exist in the general law and in the Administration for Insurers Order would have potentially beneficial consequences for some members of Lloyd's but that these benefits would not be available to other insurers. HM Treasury's response is that there would not seem to be any overriding public benefit in giving such special benefits to members of Lloyd's and therefore the provisions should remain as drafted in this respect.

Q. 13 Do consultees think the Regulations should be made by negative or affirmative resolution?

13.1 HM Treasury proposed to make these Regulations using its powers under section 2(2) of the European Communities' Act 1972. These powers allow for secondary legislation to be used to transpose a European Directive into domestic legislation.

13.2 The majority of respondents offered no views on whether the Regulations should be subject to negative or affirmative resolution.

13.2 Those that did however were all in favour of negative resolution procedure. This is the route that HM Treasury proposes to adopt.

14. General Comments

14.1 Concern was voiced that the liabilities of members or former members that were unconnected with their underwriting business with Lloyd's would be subject to the requirements of the Regulations and in particular the preference in favour of insurance

creditors. HM Treasury's response is that this arises precisely from the nature of the Lloyd's market. Further, security for debts given by members will continue to operate according to its terms.

14.2 Clarification was requested regarding whether or not priority would be sought retrospectively. HM Treasury's response is that this is indeed the case should a Lloyd's market reorganisation be made.

14.3 Two further amendments have been made to the Regulations since they were published in draft in the consultation document:

□ **Regulation 11 (12)**

This amendment relates to the period of one month for agreeing a reorganisation plan. It was suggested that this period may in some circumstances be too short. Given the time urgency in such a scenario, HM Treasury remains of the view that this time restriction should still be set at one month. However, there is now provision for the relevant party (FSA or reorganisation controller) to apply to the Court for an extension of one further month, should the necessity arise.

□ **Regulation 17**

This amendment has arisen as a result of differing insolvency laws in Scotland for natural persons. This regulations now place the legal obligation at all times on all debtors to inform trustees for creditors in Scotland if they are a member or former member of Lloyd's, in order that insolvency practitioners are advised accordingly in the event that a Lloyd's Market Reorganisation Order were to be made.

Annex A

Summary of (non-confidential) respondents to *'Implementation of the insurers' reorganisation and winding-up directive for Lloyd's – A consultation document'*

- Allen & Overy LLP
- Association of Lloyd's Members
- CBS Private Capital Ltd.
- Hampden Agencies Ltd.
- Lloyd's