

Consultation on amendments to the Financial Services and Markets Act 2000 (Exemption) Order 2001 for the role of policyholder advocate

December 2006



HM TREASURY



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to the Financial Services and
Markets Act 2000 (Exemption)
Order 2001 for the role of
policyholder advocate**

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EXECUTIVE SUMMARY

A reattribution takes place when with-profits policyholders are offered a payment in return for their agreement that they forego future claims on any future excess assets. This can happen when a life insurance company (the "insurer") wants to restructure its with-profits fund. An insurer might decide to opt for a reattribution if, for example, it decided to merge several different with-profits funds into one fund in order to reduce management costs.

However, there have been concerns that there wasn't a representative to act on behalf of the policyholders' interests and negotiate with the insurer. Policyholders were perceived as not getting the best deal. As a result, the Financial Services Authority (FSA) introduced rules that created such a role – the policyholder advocate. The policyholder advocate is an independent figure representing policyholders' interests to the insurer (and where required, to the FSA and others). Broadly, the policyholder advocate's function will be to negotiate with the insurer on behalf of policyholders in relation to the value of benefits the insurer is offering to them. He will then give the policyholders advice on whether the insurer's proposals are in their interest.

Advising on and arranging deals in rights under contracts of insurance are regulated activities under the Financial Services and Markets Act 2000 (Regulated Activities) Order 2001 (the "RAO") and a person carrying on such activities is therefore required either to be authorised by the FSA or exempt from authorisation. In order to carry out his role, it is likely that the policyholder advocate will be carrying out regulated activities. The risks involved in carrying out such a role without the appropriate authorisation or exemption are significant and are discussed in more detail in the consultation document.

As a result, this consultation paper sets out the Government's proposals to amend Part IV of the Schedule to the Financial Services and Markets Act 2000 (Exemption) Order 2001 (the "Exemption Order") to enable a policyholder advocate to carry out the functions intended in the FSA rules without being authorised by the FSA. In particular, the proposed amendments would exempt a policyholder advocate from requiring authorisation in respect of the regulated activities specified by articles 25 and 53 of the RAO, which relate to arranging deals in, and advising on, investments.

This document provides an overview of the scope and nature of the role of the policyholder advocate, explains issues that have arisen in relation to the current regime and considers the rationale for an exemption. It seeks your views on whether this exemption is sufficient to protect the interests of consumers and the policyholder advocate, and facilitate an efficient and effective reattribution process by the insurer as well as whether there may be unintended consequences as a result. The solution would be implemented via the introduction of secondary legislation and would provide legal certainty and protection for all involved in the reattribution process.

RESPONDING TO THE CONSULTATION

Consultation

1.1 The Government would welcome responses to whether Part IV of the Schedule to the Financial Services and Markets Act 2000 (Exemption) Order 2001 (the “Exemption Order”) should be amended to enable a policyholder advocate to carry out the functions intended in the Financial Services Authority (FSA) rules without being authorised by the FSA.

Questions

Do you agree that a policyholder advocate carrying out the functions intended in the FSA rules does not need to be authorised by the FSA? (pg 12)

Do you think that an exemption from authorisation in respect of the regulated activities specified in articles 25 and 53 of the Financial Service and Markets Act 2000 (Regulated Activities) Order 2001 is the most appropriate solution? (pg 13)

In the event of an exemption, do you think that the safeguards discussed provide sufficient protection to policyholders? (pg 14)

How to respond

1.2 The Government welcomes the views of all stakeholders on the issues raised in this document. The consultation period begins with the publication of this document, and will run for 12 weeks. Please ensure that your responses reach us by 15 March 2007.

Responses to the consultation should be sent to:

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1.3 This document can also be found on the HM Treasury website: www.hm-treasury.gov.uk and hard copies are available on request from Aviva Rosen or Karen Ainsworth.

1.4 When responding, please state whether you are responding as an individual or representing the views of an organisation. If responding on behalf of a larger

organisation, please make it clear who the organisation represents and, where applicable, how the view of members were assembled.

1.5 A list of those who have been sent this discussion paper is attached in Annex C. If you have any suggestions of others who may wish to be involved in this process, please contact us.

Confidentiality

1.6 All written responses will be made public on HM Treasury's website unless the author specifically requests otherwise. In the case of electronic responses, general confidentiality disclaimers that often appear at the bottom of emails will be disregarded for the purpose of publishing responses unless an explicit request for confidentiality is made in the body of the response. If you wish, part, but not all, of your response to remain confidential, please supply two versions – one for publication on the website with the confidential information deleted, and other confidential version for the team managing the consultation.

1.7 Even where confidentiality is requested, if a request for disclosure of the consultation response is made in accordance with the freedom of information legislation, and the response is not covered by one of the exemptions in the legislation, the Government may have to disclose the response in whole or in part.

1.8 Further information on the consultation process can be found in Annex B that sets out the Cabinet Office's Code of Practice for Written Consultations.

Partial impact assessment

1.9 As highlighted above, the Partial Regulatory Impact Assessment (Partial RIA) is published with this document and should be read in conjunction with it.

1.10 The Partial RIA lays out implementation options for the areas highlighted above and considers qualitative, and where possible, quantitative costs and benefits for the options.

1.11 A copy of the Partial RIA can be found on HM Treasury's website: www.hm-treasury.gov.uk or requested through HM Treasury's correspondence and enquiry unit. Contact details can be found on: http://www.hm-treasury.gov.uk/contact/contact_index.cfm

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BACKGROUND

A reattributed estate and how policyholder advocates are involved in this process

2.1 An inherited estate is defined by the Financial Services Authority (FSA) rules¹ as an amount representing the fair market value of the with-profits assets less the realistic value of liabilities of the with-profits fund and generally comprises assets that have built up in the business over a number of years. A reattribution is a process under which an insurer seeks to redefine the rights and interests that with-profits policyholders and the company have over the inherited estate. An insurer might decide to opt for a reattribution if, for example, it decided to merge several different with-profits funds into one fund in order to reduce management costs. During a reattribution, with-profits policyholders are offered a payment in return for forgoing future claims on any future excess assets. Normally, policyholders have a choice to individually accept or reject the insurer's offer and policyholders who do not agree retain their rights.

2.2 Policyholder advocates were introduced by FSA rules that took effect on 30 June 2005². This was in response to concerns that there was no representative of policyholders to negotiate the terms of a reattribution with the company.

2.3 The precise role of the policyholder advocate will depend on the nature of the insurer and its proposed reattribution. Typically, he will act as an independent person representing policyholders' interests and will negotiate the terms of the reattribution on their behalf. Normally, a report will be prepared for the policyholders setting out his views on the reattribution, including whether he considers the reattribution proposals to be in the interests of policyholders.

2.4 Given the role, the policyholder advocate should be free from any conflicts of interest which may be detrimental to the interests of the policyholders he represents. He must also have the skills and knowledge required for the role. The FSA oversees the process and nominates or approves the appointment.

¹ FSA Handbook - Glossary

² Conduct of Business Sourcebook Sourcebook (Reattribution of Inherited Estates) Instrument 2005; (COB) rule 6.13

3

THE CURRENT REGIME

Outline of current regime

3.1 Section 19 of the Financial Services and Markets Act 2000 (FSMA) provides that no person may carry on a regulated activity in the United Kingdom, or purport to do so, unless he is: (a) an authorised person; or (b) an exempt person. This is known in the Act as the general prohibition. Section 22 of FSMA provides that an activity is a regulated activity if it is an activity of a specified kind: (a) which relates to a specified investment (or, in relation to certain activities, to property of any kind); and (b) which is carried on by way of business. For these purposes “specified” means specified in the RAO.

3.2 “Rights under a Contract of Insurance” is a specified investment (article 75 of the RAO), and a policyholder advocate is likely to be carrying on two specified activities: arranging deals in investments (article 25 of the RAO); and advising on investments (article 53 of the RAO).

3.3 There are two principal elements to the “by way of business” test in this type of case, namely whether or not the person is paid for the regulated activity and whether he is taking up or pursuing the regulated activity by way of business for the purposes of section 22. Both these elements must be satisfied for the FSA to consider that the regulated activities carried on satisfy the “by way of business” test.

3.4 A policyholder advocate will almost certainly be paid to carry out the role, and so gain commercial benefit from it. It is also likely that he will be carrying out the role on an ongoing basis over a not insignificant period of time (perhaps as much as a year to 18 months) and on a relatively large scale. Therefore, it is arguable that he will meet the “by way of business” test.

3.5 As a result, the policyholder advocate either needs authorisation by the FSA or the benefit of an exemption to carry out the role without authorisation.

Issues with the current regime

3.6 One of the key functions of the policyholder advocate will be to negotiate with the insurer on behalf of policyholders in relation to the value of benefits the insurer is offering to them for the interests they are being asked to give up. He will also advise policyholders on whether the insurer’s proposals are in their interest.

3.7 It is likely that he would be carrying out regulated activities of advising on,³ and arranging deals⁴ in, rights under contracts of insurance. In the absence of authorisation this would constitute a breach of the general prohibition contained within section 19 of the Financial Services and Markets Act 2000 (FSMA). The consequences of this are serious, as:

- all agreements, where the policyholder advocate was advising, entered into by the insurer with policyholders will, subject to any order which the Court may make on enforcement, be unenforceable by the insurer against policyholders (section 27 of FSMA) ; and
- breaching the general prohibition is a criminal offence (section 23 of FSMA).

³ Article 53 of the RAO

⁴ Article 25 of the RAO

Articles 25 and 53 of the Financial Services and Markets Act 2000 (Regulated Activities) Order 2001 (the “RAO”)**Arranging deals in investments**

25. - (1) Making arrangements for another person (whether as principal or agent) to buy, sell, subscribe for or underwrite a particular investment which is –

- (a) a security,
- (b) a relevant investment, or
- (c) an investment of the kind specified by article 86, or article 89 so far as relevant to that article,
- (d) is a specified kind of activity.

(2) Making arrangements with a view to a person who participates in the arrangements buying, selling, subscribing for or underwriting investments falling within paragraph (1)(a), (b) or (c) (whether as principal or agent) is also a specified kind of activity.

Advising on investments

53. Advising a person is a specified kind of activity if the advice is –

- (a) given to the person in his capacity as an investor or potential investor, or in his capacity as agent for an investor or a potential investor; and
- (b) advice on the merits of his doing any of the following (whether as principal or agent) –
 - 1. buying, selling, subscribing for or underwriting a particular investment which is a security or a relevant investment, or
 - 2. exercising any right conferred by such an investment to buy, sell, subscribe for or underwrite such an investment.

Interpretation

[“relevant investment” means –

- (a) rights under a qualifying contract of insurance;
- (b) rights under any other contract of insurance;
- (c) any investment of the kind specified by any of articles 83, 84, 85 and 87;
- (d) any investment of the kind specified by article 89 so far as relevant to an investment falling within (a) or (c);]

4

POTENTIAL SOLUTIONS

4.1 There are two possible ways to address the issues outlined above, and hence provide legal certainty for all involved in the reattribution process. The first is for the FSA to authorise each policyholder advocate so that they become regulated by the FSA. Alternatively, the policyholder advocate may be exempted from authorisation either for all regulated activities or those activities most relevant to the role.

Option One: Authorisation

4.2 The first option considers authorising the role of policyholder advocate so that he is subject to FSA rules. This brings with it a number of practical considerations, which suggest that this might not be a viable solution. They are:

- the policyholder advocate's ability to maintain professional indemnity insurance (including minimum limits of indemnity per year of between €500,000 to €1 million for a single claim)⁵. Given we expect the policyholder advocate to be an individual rather than a firm, getting such insurance may pose difficulties in terms of availability and costs, amongst other things. Maintaining adequate financial resources could also inflate his expenses considerably – this would have to be funded by the insurer and may result in reduced benefits being offered to policyholders;
- his ability to satisfy and continue to satisfy the minimum conditions, known as the threshold conditions⁶, in order to become authorised (e.g. ensuring a firm has adequate resources, which include financial resources, non-financial resources and means of managing its resources; for example, capital, provisions against liabilities, holdings or access to cash and other liquid assets, human resources and effective means by which to manage risks). Again, being an individual rather than a firm, in a relatively short-term function, will make this more difficult; and
- there are other resource requirements that may be difficult to meet, such as when complying with high level systems and control requirements set out in FSA's Senior Management Arrangements, Systems and Controls (SYSC) rules. As a result, waivers or modifications of the FSA rules may need to be put in place. It is very likely that a significant number of waivers will be required, which will be a very time intensive process.

4.3 Furthermore, it may not be appropriate for an authorised person regulated under the FSA rules to be appointed, for all intents and purposes, to perform a regulatory function on behalf of the FSA. It could make it more difficult for the FSA to intervene or raise objections later on in the reattribution scheme if it had concerns.

4.4 The policyholder advocate also needs to be independent of any firm and act in the best interests of the policyholder. It could be argued that the FSA rules that would apply to him as an authorised person could limit his ability to do this, to the extent that such ability may be fettered by the rules.

⁵ Assuming the policyholder advocate may be authorised in a role analogous to an insurance intermediary which carries out the regulated activities in Articles 25 and 53 of the RAO.

⁶ Schedule 6 to FSMA

4.5 On the basis of the above arguments, we do not consider that authorising the role of policyholder advocate is the most appropriate solution.

Question: Do you agree that a policyholder advocate, carrying out the functions intended in the FSA rules, does not need to be authorised by the FSA?

Option Two: Exempt the role from authorisation in respect of regulated activities specified in articles 53 and 25 of the Financial Service and Markets Act 2000 (Regulated Activities) Order 2001 (the “RAO”)

4.6 The alternative is to exempt the role of policyholder advocate from authorisation under FSMA in respect of the regulated activities he is likely to be carrying on, specifically Articles 53 and 25 of the RAO. This means that he would not be subject to FSA regulation and rules.

4.7 The impact of the practical considerations discussed above make it more desirable to exempt rather than authorise the role. In this regard, the fact that a policyholder advocate is an individual without the resources often available to a firm is particularly significant.

4.8 This option also has the advantage that the policyholder advocate can carry out the functions intended in the Financial Services Authority (FSA) rules without his independence being limited by them. This is because the activities of the policyholder advocate may be reasonably regarded as an extension of the FSA’s regulatory function and as being carried on for the purpose of enabling the FSA to meet its statutory objective of protecting consumers.

4.9 Under section 39 of FSMA the Treasury has the power to exempt a person entirely from the general prohibition on carrying out financial services activities or to limit the exemption to particular activities. In this case since the concern is limited to articles 25 and 53 of the RAO, a limited exemption is appropriate. By limiting the exemption to the relevant articles of the RAO, we are trying to ensure that the exemption is no wider than necessary so that the possibility of something unintended falling within the scope of the exemption is limited. This is especially important given that the role of policyholder advocate is rather different from the other categories of exemption included in the Exemption Order⁷.

4.10 Limiting the exemption in this way would also create legal certainty for the policyholder advocate that he would not be committing a criminal offence and for the insurer and policyholders that any agreement between them would not be invalidated by the policyholder advocate carrying out this role.

Option Three: Full exemption from authorisation

4.11 A more radical option would be to exempt the policyholder advocate from the general prohibition contained in section 19 of FSMA. There does not seem any necessity to exempt the role from the whole of the general prohibition. Doing so might risk providing scope for roles other than a policyholder advocate to be exempt from FSMA.

⁷ FSMA 2000 (Exemption) Order 2001, S.I. 2001/120; as amended.

This could include people who might seek to become self-appointed policyholder champions or people who provide generic advice.

Option Four: Do nothing

4.12 There is, of course, the option to do nothing. We do not think that this is a sensible way forward given the possibility of agreements between the insurer and its with-profits policyholders being invalidated and the implications for the policyholder advocate if he were to act without authorisation or exemption (i.e. committing a criminal offence).

Question: Do you think that an exemption in respect of the regulated activities specified in articles 25 and 53 of the Financial Service and Markets Act 2000 (Regulated Activities) Order 2001 is the most appropriate solution?

Safeguards

4.13 There is, of course, the question of whether, in the absence of authorisation by the FSA, there are other mechanisms to ensure adequate control of the policyholder advocate and hence protection for the policyholders.

4.14 A number of safeguards exist in the FSA rules to ensure that the policyholders' interests are protected to an appropriate degree in a proposed reattribution. Some of these safeguards centre on the FSA's role in the appointment of the policyholder advocate including:

- FSA approves the appointment of the policyholder advocate by the insurer and is able to nominate someone to carry out the role where it is thought that would be in policyholders' interests;
- FSA has rules on some of the key terms on which a policyholder advocate must be appointed. This is to ensure that he will act independently and in the interests of policyholders; and
- the insurer is required to notify the FSA of the terms on which it proposes to appoint the policyholder advocate so the FSA can raise objections to any part of the terms of appointment in any particular case.

4.15 Equally important are the controls in place that ensure that the FSA has a role in overseeing the reattribution process, including the activities of the policyholder advocate in carrying out this function. The FSA rules require the terms of the policyholder advocate's appointment to allow for direct communication between him and the FSA. He may also participate in the FSA's meetings with the insurer. The FSA may also use its regulatory power under FSMA to intervene if it believes that there is reason for it to do so. For instance, the FSA may also require the insurer to modify its reattribution proposals or, if necessary, it will prevent the insurer from carrying out all or part of them.

4.16 The insurer is also subject to FSA rules; it must ensure that each affected policyholder receives timely and appropriate information about the reattribution process that is clear, fair, and not misleading. This should include information about the policyholder advocate, his views on the reattribution proposals and any benefits the policyholders are likely to receive and the rights and interests that they are likely to be

asked to give up, the wider restructuring of the insurer (if any), and the benefits and drawbacks of the specific reattribution proposals.

4.17 The insurer must also inform relevant policyholders when it finishes negotiating with the policyholder advocate and explain the outcome of the negotiations and its reattribution proposals. If the insurer decides to make an offer to policyholders that the policyholder advocate does not support, the insurer should explain that the policyholder advocate disagrees and give the reasons why. The insurer should also send out details of the individual benefits each relevant policyholder will receive.

4.18 An equally important safeguard for the policyholders is the opportunity to vote on any proposals that have been negotiated. Normally, policyholders have a choice to individually accept or reject the insurer's offer that has been negotiated by the policyholder advocate. In general, policyholders who do not agree retain their rights. Alternatively, policyholders may be required by court process to vote together at a court convened meeting on whether or not the insurer should go ahead with its proposal.

4.19 The normal legal process for making a reattribution is an insurance business transfer governed under Part VII of FSMA. The legal process for such a scheme requires the insurer to appoint an independent expert to assess the impact of the transfer. Where the insurer seeks to make a reattribution by any other legal mechanism, it is required to appoint a reattribution expert who will carry out an objective assessment of the impact of the reattribution proposals on the with-profits fund. The report by the independent expert or reattribution expert must be made available to policyholders and to the Court to inform their decisions.

4.20 To strengthen the above safeguards, FSA are simultaneously considering amendments to their Conduct of Business (COB) rules on additional information that may need to be provided to policyholders so that they are aware of the implications of the policyholder advocate not being an authorised person under FSMA.

Question: In the event of an exemption, do you think that the above safeguards provide sufficient protection to policyholders?

ANALYSIS

Necessary protections

4.21 The requirement to be authorised is being removed. However, the FSA rules in this area will remain to ensure policyholders are adequately protected. The FSA are also considering whether additional information may need to be provided to policyholders.

Rights and freedoms

4.22 Even though we propose the policyholder advocate should be exempted from the need to be authorised under FSMA, policyholders will still have recourse to the Financial Ombudsman Service (FOS)⁸ to complain about the insurer in respect of the way the reattribution process had been run or about the outcome. However, policyholders will not be able to go to FOS with complaints about the policyholder

⁸ The Financial Ombudsman Service generally helps settle disputes between consumers and most firms regulated by the FSA. The complainant must complain to the firm first before the FOS can look at the case.

advocate himself, as he won't be authorised by the FSA. We don't believe this will be a significant issue as policyholders can still go to FOS to complain about the insurer, as mentioned above.

4.23 Courts are usually involved in the reattribution process and this should also help to avoid unfairness. At the end of the process, policyholders would have the opportunity to vote on any proposals that had been negotiated. Normally, an insurer would give policyholders a choice on whether to or not to agree to the proposals and those who do not agree retain their rights. Alternatively, as required by legal process, policyholders are able to vote in the relevant majority on whether or not the insurer should go ahead with its proposal.

Costs and savings

4.24 The cost of securing authorisation from the FSA, and those associated with it, would be avoided if the policyholder advocate were to be exempted.

New burdens

4.25 There may be one minor burden imposed as a result of minor amendments to the FSA COB rules on additional information to policyholders so that they are aware of the implications of the policyholder advocate not being an authorised person under FSMA. This should not be unduly burdensome as any additional information requirement could form part of the general information provided to policyholders during the normal course of the reattribution process.

Compatibility with EC regulations

4.26 The EU Markets in Financial Instruments Directive (Directive 2004/39/EC) ("MiFID") regulates the buying, selling and organised trading of financial instruments and replaces the Investment Services Directive (ISD). Therefore it is necessary to analyse whether the proposal falls within the scope of MiFID.

4.27 Much of the scope of the ISD was implemented through the RAO. During transposition of MiFID it was decided to use the existing RAO activities and investments. The RAO includes language to ensure that if an issue falls within the ISD then exclusions from scope of the RAO do not apply, the so-called override. The implementation of MiFID would replace the ISD override in article 4(4) of the RAO with an updated MiFID override. The effect of the override, in respect of any activity that falls within the scope of the MiFID, is that relevant exclusions in the RAO should be disregarded if they are incompatible with the MiFID. However, the override is not relevant where a person falls within one of the MiFID's exemptions.

4.28 The proposal to exempt the role of policyholder advocate from articles 25 and 53 of the RAO does not fall within the scope of the Directive as activity carried out by the policyholder advocate doesn't constitute "investment services and activities" as listed in section C of Annex I by virtue of the investment advice given not relating to one of the financial instruments listed in the same section. The policyholder advocate also arguably does not fall within the definition of an investment firm.

A

PARTIAL IMPACT ASSESSMENT

TITLE OF PROPOSAL

A.1 Amendment to Part IV of the Schedule to the Financial Services and Markets Act 2000 (Exemption) Order 2001 (the “Exemption Order”) to enable a policyholder advocate to carry out the functions intended in the Financial Services Authority (FSA) rules without authorisation.

Purpose and intended Effect

A.2 A reattribution takes place when with-profits policyholders are offered a payment in return for their agreement that they forego future claims on any future excess assets. This can happen when a life insurance company (the “insurer”) wants to restructure its with-profits fund. An insurer might decide to opt for a reattribution if, for example, it decided to merge several different with-profits funds into one fund in order to reduce management costs.

A.3 However, there were concerns that there wasn’t a representative to act on behalf of the policyholders’ interests and negotiate with the insurer. Policyholders were perceived as not getting the best deal. As a result, the Financial Services Authority (FSA) introduced rules that created such a role – the policyholder advocate. The policyholder advocate is an independent figure representing policyholders' interests to the insurer (and where required, to the FSA and others). FSA rules require the policyholder advocate to negotiate the terms of the reattribution with the insurer on behalf of policyholders in relation to the value of benefits the insurer is offering to them. He will then publish a report setting out his views on the reattribution, including whether he considers the reattribution proposals to be in the interests of policyholders.

A.4 Advising on and arranging deals in rights under contracts of insurance are regulated activities under the Financial Services and Markets Act 2000 (Regulated Activities) Order 2001 (the “RAO”) and a person carrying on such activities is therefore required either to be authorised by the FSA or exempt from authorisation. In order to carry out his role, it is likely that the policyholder advocate will be carrying out regulated activities. The risks involved in carrying out such a role without the appropriate authorisation or exemption are significant and are discussed in more detail in the consultation document.

A.5 As a result, this consultation paper sets out the Government’s proposals to amend Part IV of the Schedule to the Exemption Order to enable a policyholder advocate to carry out the functions intended in the FSA rules without being authorised by the FSA. In particular, the proposed amendments would exempt a policyholder advocate from requiring authorisation in respect of the regulated activities specified by articles 25 and 53 of the RAO, which relate to arranging deals in, and advising on, investments.

Consultation

A.6 This consultation is important in highlighting any unforeseen and unintended consequences.

A.7 To ensure that as many people associated with the reattribution process have the opportunity to comment, copies of the consultation document will be sent to the

ALICO, Association of British Banks, Association of British Insurers, AXA, Britannic Assurance plc, Building Societies Association, The Financial Services Authority, The Financial Services Consumer Panel, Friends Provident Life and Pensions Ltd, Law Society, Lloyds TSB Bank plc, Nationwide Building Society, Phoenix Life Group, Scottish Widows, The Small Business Practitioner Panel, Sun Alliance Insurance International Limited, Zurich, APCIMS, Association of Independent Financial Advisers, Aviva plc, British Bankers' Association, Clerical Medical, The Faculty and Institute of Actuaries, The Financial Ombudsman Service, The Financial Services Practitioner Panel, HBOS, Legal and General, Prudential, The National Association of Citizen Advice Bureaux, Pearl Assurance, Scottish Life, Skandia, Standard Life, Which?

OPTIONS

Option One: Authorise the role

A.8 Authorising a policyholder advocate so that he is subject to FSA rules brings with it a number of practical considerations, which suggest that this might not be a viable solution. They are:

- the policyholder advocate's ability to maintain professional indemnity insurance (including minimum limits of indemnity per year of between €500,000 to €1 million for a single claim)⁹. Given we expect the policyholder advocate to be an individual rather than a firm, getting such insurance may pose difficulties in terms of availability and costs, amongst other things. Maintaining adequate financial resources could also inflate his expenses considerably – this would have to be funded by the insurer and may result in reduce benefits being offered to policyholders;
- his ability to satisfy and continue to satisfy the minimum conditions, known as the threshold conditions¹⁰, in order to become authorised (e.g. ensuring a firm has adequate resources, which include financial resources, non-financial resources and means of managing its resources; for example, capital, provisions against liabilities, holdings or access to cash and other liquid assets, human resources and effective means by which to manage risks). Again, being an individual rather than a firm, in a relatively short-term function, will make this more difficult; and
- there are other resource requirements that may be difficult to meet, such as when complying with high level systems and control requirements set out in FSA's Senior Management Arrangements, Systems and Controls (SYSC) rules. As a result waivers or modifications of the FSA rules may need to be put in place. It is very likely that a significant number of waivers will be required, which will be a very time intensive process.

A.9 Furthermore, it may not be appropriate for an authorised person regulated under the FSA rules to be appointed, for all intents and purposes, to perform a regulatory function on behalf of the FSA. It could make it more difficult for the FSA to intervene or raise objections later on in the reattribution scheme if it had concerns.

⁹ Assuming the policyholder advocate may be authorised in a role analogous to an insurance intermediary which carries out the regulated activities in Articles 25 and 53 of the RAO.

¹⁰ Schedule 6 to FSMA

A.10 The policyholder advocate also needs to be independent of any firm and act in the best interest of the policyholder. It could be argued that the FSA rules that would apply to him as an authorised person could limit his ability to do this.

A.11 On the basis of the above arguments, we do not consider that authorising the role of policyholder advocate is the most appropriate solution.

Option Two: Exempt from requiring authorisation in respect of regulated activities specified in articles 53 and 25 of the RAO

A.12 We propose that the role of policyholder advocate should be exempt from authorisation under FSMA in respect of the regulated activities he is likely to be carrying on, in particular Articles 53 and 25 of the RAO. Keeping the exemption limited in this way has the advantage of creating legal certainty for the policyholder advocate that he would not be committing a criminal offence and for the insurer and policyholders that any agreement between them would not be invalidated by the policyholder advocate carrying out this role. At the same time it ensures that the exemption is no wider than necessary so that the possibility of something unintended falling within the scope of the exemption is limited.

A.13 This option also has the advantage that the policyholder advocate can carry out the functions intended in the Financial Services Authority (FSA) rules without his independence being limited by them. This is because the activities of the policyholder advocate may be reasonably regarded as an extension of the FSA's regulatory function and as being carried on for the purpose of enabling the FSA to meet its statutory objective of protecting consumers.

A.14 There are also a number of practical considerations that make it more desirable to exempt than authorise the role. The fact that a policyholder advocate is an individual without the resources often available to a firm is particularly significant. Such practical hurdles could prevent people taking on the role entirely; such as maintaining professional indemnity insurance (including minimum limits of indemnity per year of between €500,000 to €1 million for a single claim) and an ability to satisfy and continue to satisfy the minimum conditions, known as the threshold conditions¹¹, in order to become authorised (e.g. ensuring a firm has adequate resources).

Option Three: Full exemption from authorisation

A.15 A more radical option would be to exempt the policyholder advocate from the general prohibition contained in section 19 of FSMA. There does not seem any necessity to exempt the role from the whole of the general prohibition. Doing so might risk providing scope for roles other than a policyholder advocate to be exempt from FSMA. This could include people who might seek to become self-appointed policyholder champions or people who provide generic advice.

Option Four: Do nothing

A.16 There is, of course, the option to do nothing. We do not think that this is a sensible way forward given the possibility of agreements between the insurer and its with-profits policyholders being invalidated and the implications for the policyholder

¹¹ Schedule 6 to FSMA

advocate if he were to act without authorisation or exemption (i.e. committing a criminal offence).

COSTS AND BENEFITS

A.17 The benefits are that legal certainty would be provided for all involved in the reattribution process. At the same time, FSA would maintain its key role in the reattribution process and continue to enforce the rules in relation to the process.

A.18 We do not anticipate any costs arising from this proposal.

Summary costs and benefits

Summary costs and benefits table		
Option	Total benefit per annum: economic, environmental, social	Total cost per annum: - economic, environmental, social - policy and administrative
1	<p>Authorise the role – Policyholder advocates would be authorised by the FSA, which would subject the policyholder advocate to FSA rules, and supervisory and enforcement powers. Policyholders may access the Financial Ombudsman Service in the event of a dispute with, or about, the policyholder advocate.</p>	<p>Policyholder advocate would need:</p> <ul style="list-style-type: none"> professional indemnity insurance (including minimum limits of indemnity per year of between €500,000 to €1 million for a single claim) to satisfy and continue to satisfy the minimum conditions in order to become authorised (e.g. ensuring a firm has adequate resources). <p>As a result, it is likely that very few people will take on the role in any meaningful way.</p>
2	<p>Exempt from requiring authorisation in respect of regulated activities specified in articles 53 and 25 of the RAO - Policyholder advocates would not be bound by the practical requirements that accompany FSA authorisation. This option has the advantage that he can carry out the functions intended in the Financial Services Authority (FSA) rules without his independence being limited by them.</p>	<p>Policyholders would not have recourse to the Financial Ombudsman Service in the event of a dispute with the policyholder advocate (but will still have recourse to complain about the insurer in respect of the way the reattribution process had been run or about the outcome)</p> <p>FSA are simultaneously considering amendments to their Conduct of Business (COB) rules on additional information that may need to be provided to policyholders so that they are aware of the implications of the policyholder advocate not being an authorised person under FSMA.</p>

Summary costs and benefits table		
Option	Total benefit per annum: economic, environmental, social	Total cost per annum: - economic, environmental, social - policy and administrative
3	Full exemption from authorisation – benefits as above.	Costs as above but additionally we run the risk of exempting a wider group of individuals/firms that are not intended to be exempt from FSA authorisation.
4	Do nothing - None	The implications for the policyholder advocate are serious were he to act without authorisation or exemption (committing a criminal offence and invalidating any agreement between the insurer and the policyholder).

SMALL FIRMS IMPACT TEST

A.19 There are currently 54 life insurers carrying out with-profits business. Of these, a significant number are likely to be affected by the proposed rule changes relating to the role of policyholder advocate. But in practice, only larger proprietary firms that are still open to new business are likely to carry out a reattribution.

A.20 It is unlikely that these proposals will impact on small firms, as they are less likely to carry out reattributions for a number of reasons:

- As a function of their smaller size, inherited estates are less likely to build up in smaller firms. So the practical issue of paying out substantial accumulated inherited estates doesn't arise as often.
- Many of the smaller with-profits funds are operated by friendly societies, which are mutuals and don't have any shareholders. They therefore would not be affected by any change to the policyholder advocate rules.
- The costs involved in a reattribution exercise can be quite significant and so may be sufficiently disproportionate to prevent many small firms going down this route.

COMPETITION ASSESSMENT

A.21 We do not envisage any detrimental effects on competition arising from this amendment. The impact will be minimal as the changes are quite small and affect a small number of financial services companies.

ENFORCEMENT, SANCTIONS AND MONITORING

A.22 As the proposed amendment is to exempt a role from authorisation under FSMA, it will not require enforcement or sanctions. However, the FSA will continue enforce its rules relating to the reattribution process and the firms role in it. FSA and HMT will also monitor whether the process is working as intended.

B

CABINET OFFICE CODE OF PRACTICE ON WRITTEN CONSULTATIONS

B.1 The Cabinet Office has published a Code of Practice for Written Consultations to guide Department's activities in this area which sets down the following criteria:

- Consult widely throughout the process, allowing a minimum of 12 weeks for written consultation at least once during the development of the policy
- Be clear about what the proposals are, who may be affected, what questions are being asked, and the timescale for responses
- Ensure the consultation is clear, concise and widely accessible
- Give feedback regarding the responses received and how the consultation process influenced the policy
- Monitor the department's effectiveness at consultation, including through the use of a designated consultation coordinator
- Ensure your consultation follows better regulation best practice, including carrying out a Regulatory Impact Assessment if appropriate.

B.2 If you feel that this consultation does not fulfil these criteria, please contact:

Christine Ermgassen
HM Treasury
1 Horse Guards Road
London
SW1A 2HQ
Telephone: (+44) (0) 207 270 5543
Email: christine.ermgassen@hm-treasury.x.gsi.gov.uk

CONFIDENTIALITY DISCLOSURES

B.3 Information provided in response to this consultation, including personal information, may be published or disclosed in accordance with the access to information regimes (these are primarily) the Freedom of Information Act 2000 (FOIA), the Data Protection Act (DPA) and the Environmental Information Regulations 2004). If you want the information that you provide to be treated as confidential, please be aware that, under the FOIA, there is a statutory Code of Practice with which public authorities must comply and which deals, amongst other things, with obligations of confidence. In view of this it would be helpful if you could explain to us why you regard the information you have provided as confidential. If we receive a request for disclosure of the information we will take full account of your explanation, but we cannot give an assurance that confidentiality will be maintained in all circumstances.

B.4 An automatic confidentiality disclaimer generated by your IT system will not, of itself, be regarded as binding on the Department. The Department will process your personal data in accordance with the DPA, and in the majority of circumstances, this will mean that your personal data will not be disclosed to third parties.

FREEDOM OF INFORMATION CONTACT

Any Freedom of Information Act queries should be directed to:

Correspondence and Enquiry Unit

Freedom of Information Section

HM Treasury

1 Horse Guards Road

London

SW1A 2HQ

Telephone: +44 (0)20 7270 4558

Fax: +44 (0) 207 270 4681

Email: public.enquiries@hm-treasury.x.gsi.gov.uk

C

LIST OF CONSULTEES

C.1 This consultation document has been made available to the general public via the Treasury public website and has in addition been sent to a large number of consultees, including the following bodies:

ALICO	APCIMS
Association of British Banks	Association of Independent Financial Advisers
Association of British Insurers	Aviva plc
AXA	British Bankers' Association
Britannic Assurance plc	Clerical Medical
Building Societies Association	The Faculty and Institute of Actuaries
The Financial Services Authority	The Financial Ombudsman Service
The Financial Services Consumer Panel	The Financial Services Practitioner Panel
Friends Provident Life and Pensions Ltd	HBOS
Law Society	Legal and General Prudential
Lloyds TSB Bank plc	The National Association of Citizen Advice Bureaux
Nationwide Building Society	Pearl Assurance
Phoenix Life Group	Scottish Life
Scottish Widows	Skandia
The Small Business Practitioner Panel	Standard Life
Sun Alliance Insurance International Limited	Which?
Zurich	



DRAFT STATUTORY INSTRUMENT

STATUTORY INSTRUMENTS

2006 No.

FINANCIAL SERVICES AND MARKETS

Financial Services and Markets Act 2000 (Exemption) (Amendment) Order 2006

<i>Made</i>	- - - -	***
<i>Laid before Parliament</i>		***
<i>Coming into force</i>	- -	***

The Treasury make the following Order in exercise of the powers conferred by section 38 of the Financial Services and Markets Act 2000⁽¹²⁾:

Citation and commencement

1. This Order may be cited as the Financial Services and Markets Act 2000 (Exemption) (Amendment) Order 2006 and comes into force on [].

Amendment of the Financial Services and Markets Act 2000 (Exemption) Order 2001

2. In Part IV of the Schedule to the Financial Services and Markets Act 2000 (Exemption) Order 2001⁽¹³⁾, after paragraph 49 insert—

“Policyholder Advocates

50.—(1) A person acting as a policyholder advocate is exempt from the general prohibition in respect of any regulated activity of the kind specified by article 25 or 53 (arranging deals in investments or advising on investments) of the Regulated Activities Order⁽¹⁴⁾ in so far as he carries on these activities in connection with, or for the purposes of, his role as policyholder advocate in accordance with the Conduct of Business Sourcebook (Reattribution of Inherited Estates) Instrument 2005⁽¹⁵⁾ made by the Financial Services Authority on 20 January 2005 pursuant to sections 138, 156 and 157(1) of the Act.

(2) in sub-paragraph (1), "policyholder advocate" means a person approved as such by the Financial Services Authority, who is appointed to negotiate with another person on its proposals for redefining the rights and interests in any surplus assets arising from that other person carrying on any regulated activity of the kind specified by article 10 of the Regulated Activities Order (effecting and carrying out contracts of

⁽¹²⁾ 2000 c. 8.

⁽¹³⁾ S.I.2001/1201, amended by S.I. 2001/3623; there are other amending instruments but none is relevant.

⁽¹⁴⁾ S.I.2001/544, to which there are amendments not relevant to this Order.

⁽¹⁵⁾ FSA 2005/6

insurance) which it carries on in relation to the investment of the kind specified by article 75 of the Regulated Activities Order (contracts of insurance).”

Two of the Lords Commissioners of Her Majesty’s Treasury

October 2006

EXPLANATORY NOTE

(This note is not part of the Order)

This Order amends the Schedule to the Financial Services and Markets Act 2000 (Exemption) Order 2001 (SI 2001/1201) (“the Schedule”), which provides for certain persons to be exempt from the general prohibition imposed by section 19 of the Financial Services and Markets Act 2000 (c.8) (“the Act”).

Article 2 adds a person who is approved or nominated by the Financial Services Authority (“FSA”) to act as a policyholder advocate to Part IV of the Schedule and exempts that person from requiring authorisation in respect of activities specified by articles 25 and 53 of the Financial Services and Markets Act 2000 (Regulated Activities) Order 2001. The FSA rules in relation to policyholder advocates, made under section 138 of the Act, can be found in the part of the FSA handbook entitled “conduct of business”.

A regulatory impact assessment has not been prepared as this amendment has no impact on the cost of business.

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