Impact assessment of amendments relating to Part 7 of the Financial Services and Markets Act 2000 ("FSMA")

June 2008

HM TREASURY

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ISBN 978-1-84532-472-8
PU491

SUMMARY: INTERVENTION & OPTIONS

Department	Impact Assessment of
HM Treasury	Impact Assessment of amendments relating to Part 7 of the Financial Services and Markets Act 2000 (“FSMA”)

Stage	Version	Related Publications
Implementation	2	- Consultation on amendments relating to Part 7 of FSMA 2000 (Control of Business Transfers) - Summary of consultation responses

http://www.hm-treasury.gov.uk/consultations_and_legislation/fsma/part7fsma/consult_part7fsma_index.cfm

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What is the problem under consideration? Why is government intervention necessary?

Concerns have been expressed by practitioners that the extent of the powers of the court to order the transfer of property under Part 7 of FSMA, in connection with insurance business transfer schemes, needs clarification. Also, an (unintended) effect of the current definition of “former underwriting member” at Lloyd’s is to exclude certain former members from being able to transfer their business under Part 7. Government action is required as legislative change is needed.

What are the policy objectives and the intended effects?

The policy objectives are to aid the effective operation of the transfer provisions in Part 7 by clarifying, for the avoidance of doubt, that the court is to be taken as always having had the power to transfer property relating to a proposed transfer scheme and override specified entitlements such as termination rights triggered by moves to undertake a transfer. In relation to Lloyd’s, they are to bring all former underwriting members within the scope of Part 7, so all business, whenever written, is capable of transfer.

What policy options have been considered? Please justify any preferred option.

1. Do nothing
2. Make legislative amendments in relation to clarification of the court’s powers and amending the definition of former underwriting members
3. As for 2 above, plus an amendment to provide for direct notification of reinsurers who are affected under proposed transfers.

Part 7 promotes economic activity and insurance company efficiencies, eg through restructuring. Option 3 is preferred to ensure it operates as effectively as possible, and to recognise that reinsurers stand alongside policyholders (including reinsurance policyholders) as those most liable to be affected under transfers, by strengthening notification arrangements for them so they can exercise existing rights under Part 7 to make representations to the court.

When will the policy be reviewed to establish the actual costs and benefits and the achievement of the desired effects? 06/2011

Ministerial Sign-off For final proposal/implementation stage Assessments:

I have read the Impact Assessment and I am satisfied that (a) it represents a fair and reasonable view of the expected costs, benefits and impact of the policy, and (b) that the benefits justify the costs.

Kitty Ussher

Signed by the responsible Minister: Date: 6 June 2008

SUMMARY: ANALYSIS & EVIDENCE

Policy Option ***Description***

ANNUAL COSTS

One off (Transition) £- Yrs -

Average Annual Cost (excluding one-off)

£ 254

Description and scale of **key monetised costs** by 'main affected groups'

Requirement to notify reinsurers affected under proposed transfers.

£. 2,795

Other **key non-monetised costs** by 'main affected groups'

ANNUAL BENEFITS

One off £ - Yrs

Average Annual Benefit (excluding one-off)

£ 16,515

Description and scale of **key monetised benefits** by 'main affected groups'

Benefits arising to transferors and transferees from increased clarity of the provisions, to reduce the legal costs of conducting transfers and/or reduced litigation costs arising out of post-transfer challenges to the court's jurisdiction.

£ £ 181, 672

Other **key non-monetised benefits** by 'main affected groups'

Promotion of viable and sustainable insurance and banking concerns.

Key Assumption/Sensitivities/Risks Key assumptions: discount rate of 3.5%. Period assumed to be 10 years.

Price Base Year 2007	Time Period Years 10	**Net Benefit Range** (NPV) **£-**	**NET BENEFIT** (NPV Best estimate) **£ 178,877**

What is the geographic coverage of the policy/option?	UK wide
On what date will the policy be implemented?	June/July 2008
Which organisation(s) will enforce the policy?	Courts, FSA
What is the total annual cost of enforcement for these organisations?	0
Does enforcement comply with Hampton principles?	Yes
Will implementation go beyond minimum EU requirements?	No
What is the value of the proposed offsetting measure per year?	£-

What is the value of changes in greenhouse gas emissions?			£ N/A	
~~Will the proposal have a significant impact on competition?~~			No	
~~Annual cost (£-£) per organisation (excluding MicroSmall~~ one-off) Are any of these organisations exempt?NoNo			~~Med~~	Large
			No	No

Impact on Admin Burdens Baseline (2005 Prices)

Increase of £Decrease of £

Net Impact **£** (Increase - Decrease) £2579

Key: **Annual Cost: Constant Prices** **(Net) Present Value**

Evidence Base for Summary Sheets

1. PROPOSAL

1.2Part 7 FSMA sets out a process of court approval for transfers of insurance business. Other than for several tightly defined exclusions, transfers of UK insurance business (including reinsurance business) within the European Economic Area must be conducted under Part 7.

1.3(Part 7 also applies to banking business transfers, though it is not a requirement for such transfers. These proposals are being pursued primarily for the purposes of insurance business transfers.)

1.4An insurer may wish to embark on a transfer of business for commercial reasons, for reasons of economies of scale or because there is a chance that the business may be at risk of insolvency but for such reorganisation.

1.5 The key aspects of these proposals aim to:

- put beyond all doubt that property and liabilities (for example, certain reinsurance contracts) which would not otherwise be transferable or assignable can be transferred by order of the court under Part 7;
- require applicants seeking a court order for a transfer of insurance business to notify all reinsurers, whose reinsurance contracts will also be transferred, of the proposed transfer of insurance business;
- extend the eligibility for participation in a transfer scheme to certain former members of Lloyd's who are currently excluded from the scope of these provisions.

1.6Given that the uncertainties in question arise from legislative provisions in FSMA, the most appropriate way in which they can be addressed is through legislative amendment. HM Treasury therefore considers that Government intervention is required.

Reinsurance contracts related to insurance business

1.7Part 7 does not make express provision for any accompanying transfer of reinsurance and other contracts (and the benefits offered by them) alongside a Part 7 transfer of the insurance liabilities to which they relate.

1.8Whilst there seems to be no doubt that reinsurance (and other related contracts) are included within the scope of the existing provisions, the current drafting is such that concerns exist as to the transferability of those contracts, for example, without the express consent of the reinsurer in question, or in the event that a contractual term exists that purports to prohibit such a transfer in one way or another.

1.9As a consequence, it is possible that a court considering an application for a transfer scheme might interpret its powers as being limited in respect of ordering the transfer of a contract, which would not otherwise, for one reason or another, be able to be transferred.

1.10 Some concerns have been raised that this perceived lack of clarity may deter some insurers from embarking on such a scheme for fear of a lack of legal certainty on the issue. A concern arising purely from a lack of clarity in the relevant legislation should not be a factor in an insurer's decision in this regard. Hence, clarification is necessary to ensure that an insurer is able to make an application for a transfer based purely on commercial grounds (subject of course to meeting the conditions set out in Part 7 and satisfying the court), not a fear of potential legislative barriers which could jeopardise the foundations of a transfer scheme. Increased clarity will also aid the effective operation of the provisions.

1.11 In the event of a transfer going ahead or simply being considered by an insurer in liaison with its legal advisers, legal costs would be higher if the legislation were to remain as it currently is. Legal uncertainty amongst parties involved in a transfer might lead to more legal advice being sought than would be necessary if Part 7 provisions were clarified. It has been estimated that approximately 10% of the current cost of a typical Part 7 insurance transfer could be saved as a result of these proposals. Although one consultee felt that this was an over estimate, but that significant savings could instead be available from the resulting greater certainty to avoid possible future litigation.

1.12 Furthermore, if, as sometimes happens, a reinsurer declines to pay out on a reinsurance contract (particularly those that are older or those in respect of which losses have already been incurred), there may be a prolonged period when the reinsured insurer has to pay out of its own money and then take a decision regarding whether or not to pursue the reinsurer for the debt, either in part or full. This process may also involve additional legal costs. Any potential uncertainty about the enforceability of amounts due (as a result of unclear legislation, for example), only serves to strengthen the hand of an indebted reinsurer and make it more likely that a reluctant payer may choose to dispute its liability. Thus increased legal costs might be a direct result of legal uncertainty.

Notification of reinsurers

1.13 Those who allege they would be adversely affected by transfers have the right, under Part 7, to make representations to the court. This is an important safeguard. To help ensure they are in a position to exercise those rights, publication and notification requirements are in place for insurance business transfer schemes. The court may not determine a transfer application if the requirements have not been met, though it has the power to disapply them. At present, insurance and reinsurance policyholders receive direct notification of transfers which impact on them, but no other classes of person. Reflecting that reinsurers stand alongside policyholders as being amongst those most likely to be affected by a transfer of insurance or reinsurance business, it is proposed to extend direct notification to them.

Definition of "former underwriting member"

1.14 The FSMA definition of former underwriting members ("Names") of Lloyd's excludes from its scope those members who resigned prior to 24 December 1996. This cut-off point is necessary for the purposes of ensuring that those Names who resigned prior to this date are not regulated under FSMA. However, in respect of Part 7 provisions for the transfer of insurance business, there is no good reason to maintain this distinction. Hence, in respect of these provisions only, it is proposed that the drafting be amended to extend these possibilities to all former members, regardless of when they resigned.

1.15 A risk could materialise in the event of the legislation remaining unamended, with regards to Equitas, the run-off reinsurer of 1992 and prior years non-life business at Lloyd's. This is because Equitas does not have open to it at present the same number of possible options for a restructuring of its business as other insurers. If the business of certain former Names were not able to be transferred because of legislative restrictions, Equitas would only be able to consider a transfer of its own reinsurance business, rather than also having the option of exploring the possibility of a transfer of the entire chain of business.

1.16 Equitas announced in 2006 that it may propose a transfer to a member of the Berkshire Hathaway group. These amendments, though, would not require that to happen, they would merely allow such a transfer to deal with all liabilities of all former names. The issue as to whether such a transfer should go ahead would be for the commercial parties involved and for the court to consider in giving or withholding its approval to such a scheme.

2. COSTS AND BENEFITS

2.1The benefits and costs outlined in this assessment are those that are relevant in the event that an insurer embarks on a transfer of business. Of course, this is an entirely optional course of action. As such, any benefits and/ or costs will only be incurred by virtue of an active decision on the part of an insurer to embark on this course of action and it is reasonable to assume that such a decision would be made in full awareness of those benefits and costs.

3. WHO WILL BE AFFECTED

3.1These proposals potentially affect all bodies and individuals operating in the insurance market, as any of these has the ability to undertake a transfer of insurance business. All bodies and individuals operating in the reinsurance market also have the potential to be affected by these proposals in the event that any insurance liabilities they are reinsuring become the subject of an insurance transfer scheme. They may also undertake transfers themselves.

4. EQUITY AND FAIRNESS

4.1The Government considers that the measures introduced will not have a disproportionate impact on the groups identified.

5. IMPACT ON SMALL FIRMS

5.1The Government's view is that there will not be a disproportionate impact on small business. The Treasury spoke to the Small Business Service at the pre-consultation stage and outlined these proposals to them. It was agreed that embarking on a transfer of insurance business is entirely a voluntary decision and, as such, any impact on a small firm (as indeed with a larger one) would only be pursuant to such a decision on the part of that firm to go down this route at all. In any case, the benefits and costs of these proposals would apply equally to small firms as to larger ones.

6. IMPACT ON COMPETITION

6.1As previously explained, the decision to embark on a transfer of insurance business is entirely a voluntary one and could take place anywhere within the insurance market, and involving any number of associated parties (eg. policyholders and reinsurers, as well as the insurer). The improved clarity of the transfer provisions should aid the efficient conduct of transfers and promote efficient and sustainable insurance companies.

7. EQUALITY ASSESMENTS

7.1 The proposals have no impact on race, disability or gender equality.

8. HUMAN RIGHTS

8.1 In relation to these amendments the Economic Secretary to the Treasury has made the following statement regarding Human Rights:

> In my view the provisions of the Financial Services and Markets Act 2000 (Amendments to Part 7) Regulations 2008 and the Financial Services and Markets Act 2000 (Amendment of section 323) Regulations 2008 are compatible with the Convention rights.

Specific Impact Tests - Checklist

Use the table below to demonstrate how broadly you have considered the potential impacts of your policy options.

Ensure that the results of any tests that impact on the cost-benefit analysis are contained within the main evidence base; other results may be annexed.

Type of testing undertaken	***Resultsin Evidence Base? (Y/N)***	***Results annexed? (Y/N)***
Competition Assessment	*Y*	*N*
Small Firms Impact Test	*Y*	*N*
Legal Aid	*N/A*	*N/A*
Sustainable Development	*N/A*	*N/A*
Carbon Assessment	*N/A*	*N/A*
Other Environment	*N/A*	*N/A*
Health Impact Assessment	*N/A*	*N/A*
Race Equality	*Y*	*N*
Disability Equality	*Y*	*N*
Gender Equality	*Y*	*N*
Human Rights	*Y*	*N*
Rural Proofing	*N/A*	*N/A*

Annexes

PRESENT VALUE CALCULATIONS

BENEFITS

	YEAR	DISCOUNT FACTOR	BENEFIT
T_O	2008	3.5%	£ 19,500
T_1	2009	3.5%	£ 18,840.9
T_2	2010	3.5%	£ 18,203.3
T_3	2011	3.5%	£ 17,587.1
T_4	2012	3.5%	£ 16,992.3
T_5	2013	3.5%	£ 16,419
T_6	2014	3.5%	£ 15,863.3
T_7	2015	3.5%	£ 15,327
T_8	2016	3.5%	£ 14,808.3
T_9	2017	3.5%	£ 14,307.2
T_{10}	2018	3.5%	£ 13,823.6
		Total:	£ 181,672

TOTAL BENEFIT (PRESENT VALUE) = £ 181, 672
AVERAGE ANNUAL BENEFIT = £ 16,515

COSTS

	YEAR	DISCOUNT FACTOR	COSTS
T_O	2008	3.5%	£ 300
T_1	2009	3.5%	£ 289.9
T_2	2010	3.5%	£ 280
T_3	2011	3.5%	£ 270.6
T_4	2012	3.5%	£ 261.4
T_5	2013	3.5%	£ 252.6
T_6	2014	3.5%	£ 244
T_7	2015	3.5%	£ 235.8
T_8	2016	3.5%	£ 227.8
T_9	2017	3.5%	£ 220.1
T_{10}	2018	3.5%	£ 212.7
			£ 2,794.9

TOTAL COSTS (PRESENT VALUE) = £ 2,795
AVERAGE ANNUAL COST = £254

KEY ASSUMPTIONS AND FACTS

Insurance business tranfers

● There are about 20 transfers of insurance business approved by the courts under Part 7 FSMA each year.

● The legal costs of transfers are estimated to be in the ranges of £80,000 to £100,000 for a straightforward intra-group transfer, and £100,000 to £500,000 for transfers to third parties, depending on complexity

● 50% of transfers are intra-group.

● 50% of transfers are to third parties.

● Savings of approximately 10% of legal costs are assumed, through greater clarity and certainty in the process of conducting transfers, and reduced litigation costs post-transfer, eg through fewer challenges to the court's jurisdiction.

● 50% of transfers of involve re-insurers.

COST/BENEFIT COMPARISONS

There are no benefits to failing to implement these amendments. Some potential transferors may be dissuaded through lack of legal certainty. Certain ex-Names will be unable ever to transfer their business under Part 7.

Costs and benefits of the proposal are:

Benefits,

Benefits of the legislation option arise through reduced legal costs, due to greater clarity and certainty in the process of conducting transfers, and reduced litigation costs post-transfer. These benefits occur to two groups, Intra-group and third parties.

Intra-group benefits = £ 90,000 x 0.5 x 0.1 = £ 4,500
Third party benefits = £ 300,000 x 0.5 x 0.1 = £15,000
£19,500

Costs

Administrative costs arise because of the requirement to notify reinsures of insurance business transfer schemes. It is assumed that such costs would only be incurred in 50% of cases, and would take a member of the administrative staff a total of two hours.

Administrative cost = £15 x 2 x 10 = £ 300

ISBN 978-1-84532-472-8