

Insurers (Reorganisation and Winding-Up) (Lloyd's) Regulations 2005

A Question & Answer Guide

Q. What is the purpose of these Regulations?

A. These Regulations implement the EU Insurers Reorganisation and Winding-Up Directive (2001/17/EC) into UK law. This Directive 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.

The principle purposes of the Directive are to simplify proceedings when an EU insurance undertaking is in financial difficulties. It does this by requiring procedures for the reorganisation or distribution of assets; the co-ordination of reorganisation and winding-up arrangements across Member States through mutual recognition; and ensuring that all EU creditors are treated equally.

The Directive was implemented in respect of all other insurers in the UK by the Insurers (Reorganisation and Winding-up) Regulations 2003 and 2004. These new Regulations now give effect to the Directive in respect of the Lloyd's market as well.

Q. Why do these Regulations have to be made?

A. The UK has an obligation under European Communities' Act 1972 to implement EU law into domestic legislation. Non-compliance with this obligation is a breach of a Member State's treaty obligations and can lead to the Commission launching infraction proceedings against that Member State. This Directive was negotiated by all Member States for the benefit of the whole insurance market across the EU. These Regulations constitute completion of the UK's obligation in respect of transposition of this Directive into domestic law.

Q. How do the Regulations work?

A. 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.

These Regulations provide the necessary link between the association and the persons and entities within the Lloyd's market that have legal personality. In some circumstances the reorganisation or insolvency of an underwriting member is to be treated as falling within the ambit of the Directive and not the Insolvency Regulation, which otherwise will continue to apply to insolvencies of particular members rather than to the association as a whole. These circumstances will arise in the event that 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.

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

Q. What consultation has taken place in relation to these Regulations?

A. HM Treasury has worked closely with the FSA in the course of drafting these Regulations to ensure that they offer the most effective means of complying with the UK's obligation to implement the EU Directive, whilst at the same time offering appropriate protection to both policyholders and Names themselves. The

consultation document for these Regulations, as with all HM Treasury consultation documents, was published on HM Treasury's public website. The Regulations were widely available to the public for the duration of the 13-week consultation period that ended on 11 March 2005. Any individual wishing to view and comment on HM Treasury's proposals was entirely at liberty, indeed was encouraged, to do so. A feedback statement on the consultation responses was published together with the Regulations on HM Treasury's public website on 21 July 2005.

Q. In what circumstances could a Lloyd's market Reorganisation Order (LMRO) be sought?

A. A Court can make an LMRO upon application by the Society of the FSA, in the event that it appears that the regulatory solvency margin imposed by FSA rules is not or may not be met, and the order is likely to meet one of both of its defined objectives. The objectives of the order will be to preserve or restore the financial situation of, or market confidence in, the association of underwriters known as Lloyd's in order to facilitate the carrying on of insurance market activities by members at Lloyd's, or to assist in achieving an outcome that is in the interests of creditors of members and insurance creditors in particular. The reorganisation order will specify the persons to which it will apply.

Q. Do you intend to use these Regulations shortly?

A. No. The ability to seek an order only becomes usable in the event that the Lloyd's market does not, or appears unlikely to, meet its regulatory solvency requirements. The ultimate decision to grant an order is at the discretion of the Courts.

Q. Do the Regulations facilitate the provisions of the Fairness in Asbestos Injury Resolution (FAIR) Bill in the United States?

A. No. There is no connection between the FAIR Bill and these Regulations. These Regulations constitute the UK's transposition of European Directive 2001/17 into domestic legislation in respect of Lloyd's. The Regulations arise from the UK's obligation under the European Communities' Act 1972 to comply with all EU law.

EU law is independent of US law and, as such, the FAIR Bill has had no bearing on the making of these Regulations.

Q. Why was it necessary to have separate Regulations for Lloyd's if as you say these Regulations do for Lloyd's what the earlier Regulations did for all other UK insurers?

A. There were difficult issues over how to apply the provisions of the Directive to the Lloyd's market, which has unique features not found in other European insurers. These differences meant that further complex adaptation and refinement of the earlier Regulations were required. HM Treasury consulted on its proposed approach in *'Implementation of the insurers reorganisation and winding-up directive for Lloyd's – A consultation document'*, published in December 2004

Q. Do these Regulations enable the FSA to sequestrate Names' assets?

A. No. The Regulations give power to the FSA, along with the Society of Lloyd's, to apply to the Courts for the making of a Lloyd's Market Reorganisation Order and for the appointment of a Reorganisation Controller. In the event that a Name then proved unable to pay his debts and thus became subject to the priority provisions of the Regulations, priority over the Name's unencumbered assets would arise within the insolvency procedures (whether instituted by the Name, his creditors or the Reorganisation Controller). As such, neither the Reorganisation Controller, nor the FSA, would have the power to "sequestrate" assets. The Reorganisation Controller, as an officer of the Court, has no special responsibility to the FSA and would act independently of it within the frame provided by the LMRO. "Sequestration" as used in the Regulations refers only to certain bankruptcy related proceedings in Scotland under the Bankruptcy (Scotland) Act 1985.

Q. Is the Lloyd's Market Reorganisation Order the trigger for granting priority to insurance creditors over other unsecured creditors?

A. No. The LMRO provides for the imposition of a moratorium and the application of the Insurers (Reorganisation and Winding-Up) Regulations 2003 and 2004 to all involved Names. The moratorium will not act to prevent the enforcement of security held by lenders. The possibility for priority to be established over Names' unencumbered assets (members' mortgages or other secured borrowing are not affected) is one of several provisions that may or may not arise from this situation, and is dependent on the ability or otherwise for each individual Name to meet his financial obligations. The LMRO provides the framework within which the provisions of the Regulations are able to operate, should they be required to do so. As such, the LMRO is therefore not in itself the trigger event; rather, it is the inability or likely inability of particular Names caught within the scope of the LMRO to pay their debts. Members may also apply to the Court to be excluded from the scope of any LMRO if they are able to demonstrate that they can meet all of their insurance debts and they would consequently not be subject to the priority provisions at all.

Q. Will Names' existing loans or mortgages take second place to debts owed by Names to their insurance creditors?

A. No. Where a lender has security under the terms of the loan over particular assets of the Name he will remain able to enforce that security, for instance by taking steps to exercise a power of sale under a mortgage, in order to obtain repayment of the amount owed to him.

Q. Are the provisions in the Regulations retrospective?

A. Yes. The Directive affects all insurers by making all reorganisation measures and winding-up procedures that take place after 20 April 2003 subject also to the provisions contained within the Directive. All insurance claims whenever instituted on policies covered by an insurer subject to such measures or proceedings are therefore affected. In the case of Lloyd's, only at the point of the making of an LMRO would this retrospective

aspect take effect with regard to a particular member who proved unable to meet his financial obligations to his creditors.

Q. Is it correct that the Regulations apply to all Names, past and present?

A. Yes. Given that the provisions of the Directive affect potentially all outstanding insurance liabilities whenever they arise or arose, the Regulations must apply to all Names not excluded from the LMRO. This is the case whether the Name in question is a current or a former member.

Q. How will these Regulations affect Names reinsured into Equitas?

A. As a reinsurance company, Equitas itself does not directly fall within the scope of the Directive, which relates only to direct insurance undertakings. Only in the event that there were a wider Lloyd's market failure so serious as to call into question the adequacy of the Society's Central Fund or if, in the particular circumstances surrounding a failure of Equitas, there were to be consequences which jeopardised the ability of the Lloyd's market to pass its regulatory solvency tests, would these Regulations come into effect in relation to Equitas. In such a scenario, Equitas Reinsured Names could be caught within the scope of an LMRO. The Regulations do not, in the event of the insolvency of Equitas, have the effect of mutualising losses, or of altering the relationship between Equitas and those Names reinsured by it.

Q. Did Lloyd's instigate the provisions of these Regulations?

A. No. European Directive 2001/17 was adopted by the European Parliament and the Council of the European Union on 19 March 2001, following a proposal from the European Commission published in 1989. These Regulations implement this Directive into domestic legislation in the UK for the benefit of the entire EEA insurance market. The Directive was negotiated by, and for the benefit of, all Members States, and, as such, it does not in any way arise from, or apply exclusively to, Lloyd's, but rather to every insurance undertaking across the EEA.