



BANK OF ENGLAND  
PRUDENTIAL REGULATION  
AUTHORITY

Consultation Paper | CP21/14

# Policyholder protection

October 2014

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## 1 Introduction

1.1 This consultation paper (CP) sets out proposed changes to the Prudential Regulation Authority's (PRA's) rules for insurance policyholder protection. The proposals in this CP aim to align the existing compensation rules more closely with the PRA statutory objectives, and in particular contribute to securing an appropriate degree of protection for those who are, or may become, policyholders. The proposals also contribute to the future operational effectiveness of the Financial Services Compensation Scheme (FSCS) in providing continuity of cover, benefits falling due and compensation in the event of the failure of a firm.

1.2 This CP is one of four papers published by the PRA on 6 October 2014 as part of the PRA's wider resolution and resilience agenda. CP20/14 sets out proposals for enhanced depositor protection and measures to facilitate better access to protected deposits in the event of a firm failing.<sup>(1)</sup> This is supported by discussion of proposals on ensuring operational continuity in resolution for banks, building societies and investment firms (see Discussion Paper DP1/14)<sup>(2)</sup> and by the PRA's first package of consultation proposals to implement ring-fencing requirements of core UK financial services and activities (see CP19/14),<sup>(3)</sup> as required under the Financial Services and Markets Act 2000 (FSMA) (as amended by the Financial Services (Banking Reform) Act 2013).

1.3 Overall, these measures advance the PRA's general objective of promoting the safety and soundness of firms by reducing the adverse effect that the failure of firms could be expected to have on the UK financial system.

1.4 This CP also forms part of a series of consultations aimed at replacing the Compensation sourcebook (COMP) and those parts of the Fees sourcebook (FEES) applicable to FSCS levies (primarily FEES 6) inherited from the Financial Services Authority. These changes follow the commitment made in the PRA's Approach Documents to publish a rulebook containing only PRA rules.<sup>(4)</sup> The PRA is proposing separate scheme rules for insurance (this CP) and deposits (see CP20/14).

1.5 This CP proposes a new policyholder protection statement of policy for the FSCS.

1.6 This CP is relevant to UK insurers (including those that establish a branch or operate on a freedom of services basis in the European Economic Area (EEA)) as well as EEA insurers that establish a UK branch or operate in the United Kingdom on a freedom of services basis, and Channel Islands insurers and Isle of Man insurers with UK, Channel Island or Isle of Man risks or commitments (PRA-authorized insurers).<sup>(5)</sup> It is also relevant to 'persons' (firms) that have assumed responsibility for liabilities from the foregoing PRA-authorized insurers

(successors), the FSCS, the Society of Lloyd's and policyholders.

1.7 Finally, the proposed FSCS Management Expenses Levy Limit and Base Costs Part and the Management Expenses in respect of Relevant Schemes Part are being consulted on in CP20/14. These are also relevant to PRA-authorized insurers, the FSCS and the Society of Lloyd's.

### Background

1.8 The proposals in this CP aim to create an effective policyholder protection compensation scheme that provides greater protection for policyholders through enhanced compensation scheme rules. The proposals align FSCS protection for insurance policyholders more closely with the PRA's insurance objective.

1.9 The new rules will take effect in July 2015. The proposed rules are included in the Policyholder Protection Part in Appendix 1 and the Lloyd's Part in Appendix 2. The proposed statement of policy is set out in Appendix 3.

### Other domestic initiatives

1.10 The PRA published CP16/14 *Transposition of Solvency II: Part 3* in August 2014. Solvency II is a significant reform of European insurance regulation. It is intended to provide greater protection for policyholders through an enhanced prudential regime. When Solvency II comes into effect, certain provisions will affect how firms calculate their FSCS levy under Chapter 21 of the Policyholder Protection Part. Given this, the PRA will need to make amendments to Chapter 21 to take account of Solvency II developments, and intends to consult on a set of proposals to implement these changes in due course.

### Statutory obligations

1.11 In discharging its general functions of making rules, and determining the general policy and principles by reference to which it performs particular functions, the PRA must, so far as reasonably possible, act in a way that advances its general objective to promote the safety and soundness of the firms it regulates. The proposed changes contribute to securing an appropriate degree of protection for policyholders and

(1) *PRA Consultation Paper CP20/14*, 'Depositor protection', October 2014; [www.bankofengland.co.uk/pr/Pages/publications/cp/2014/cp2014.aspx](http://www.bankofengland.co.uk/pr/Pages/publications/cp/2014/cp2014.aspx).

(2) *PRA Discussion Paper DP1/14*, 'Ensuring operational continuity in resolution', October 2014; [www.bankofengland.co.uk/pr/Pages/publications/cp/2014/dp114.aspx](http://www.bankofengland.co.uk/pr/Pages/publications/cp/2014/dp114.aspx).

(3) *PRA Consultation Paper CP19/14*, 'The implementation of ring-fencing: consultation on legal structure, governance and the continuity of services and facilities', October 2014; [www.bankofengland.co.uk/pr/Pages/publications/cp/2014/cp1914.aspx](http://www.bankofengland.co.uk/pr/Pages/publications/cp/2014/cp1914.aspx).

(4) *The PRA's approach to banking supervision*, June 2014; [www.bankofengland.co.uk/publications/Documents/prapproach/bankingappr1406.pdf](http://www.bankofengland.co.uk/publications/Documents/prapproach/bankingappr1406.pdf). *The PRA's approach to insurance supervision*, June 2014; [www.bankofengland.co.uk/publications/Documents/prapproach/insuranceappr1406.pdf](http://www.bankofengland.co.uk/publications/Documents/prapproach/insuranceappr1406.pdf).

(5) For the purposes of this CP, we include all such firms when we refer to 'PRA-authorized insurers', even though EEA insurers will, in fact, be authorised by their own home state regulator.

beneficiaries. In addition, the proposals also support the PRA's general objective by seeking to minimise the adverse effect that the failure of a PRA firm could be expected to have on the stability of the UK financial system.

1.12 In making its rules and establishing its practices and procedures, the PRA must have regard to the Regulatory Principles as set out in FSMA. These require the PRA to exercise its functions as transparently as possible. The principle of proportionality in particular requires the PRA to ensure that any burden or restriction imposed by rules is proportionate to the expected benefits. The PRA has followed these principles when developing the rules outlined in this CP.

### Economic impact

1.13 FSMA requires the PRA to perform an economic assessment of the impact of its proposals. The PRA has estimated costs and benefits where it is reasonably practicable to do so.

1.14 The cost-benefit analysis (CBA) in this CP is focused on discretionary policy decisions proposed by the PRA to implement proposals on: limits, FSCS powers to require information from firms, FSCS powers to be automatically subrogated or assigned to policyholders' rights and clarifying the compensation cost levy. As the other proposals clarify existing rules, the PRA does not expect these to lead to material additional costs or benefits.

1.15 Direct costs to the PRA arising from the proposals are expected to be minimal and should be absorbed into the general operational costs of the PRA. The PRA does not expect firms to incur direct compliance costs from the proposals. The proposed rules are expected to increase payout costs to the industry where a firm fails due to higher compensation costs. The magnitude of this depends on the future incidence of firm failures.

1.16 A more detailed CBA of the proposals is included within each relevant chapter of this CP.

### Impact on mutuals

1.17 The PRA has a statutory requirement to state whether the impact on mutuals will be significantly different from the impact on other firms. The PRA does not expect the impact on mutuals to be significantly different from the impact on other firms.

### Impact on competition

1.18 The PRA has a duty to facilitate competition as a secondary objective subordinate to its general safety and soundness objective and insurance objective. The PRA does not expect there to be a significant impact on competition as a direct result from the proposed rules.

### Equality and diversity

1.19 The PRA may not act in an unlawfully discriminatory manner. It is also required, under the Equality Act 2010, to have due regard to the need to eliminate discrimination and to promote equality of opportunity in the carrying out of its policies, services and functions. To meet this requirement, the PRA has performed an assessment of the equality and diversity implications of any new policy proposals considered. In general, the PRA has found that the issues addressed in this CP do not give rise to equality and diversity implications.

1.20 There may be some positive effects from enhanced cover on the retired, those receiving annuities and disabled persons, if they have become disabled through critical illness and are receiving payments from a protection policy, and those required to take out professional indemnity insurance. The positive effect will be in the form of greater FSCS protection should their insurance provider fail and reduced delays or disruption in receiving any benefits falling due during the continuity phase and compensation payments.

### Responses and next steps

1.21 This consultation closes on 6 January 2015. The PRA welcomes views on its proposed changes to the PRA rules for policyholder protection. In particular, the PRA welcomes comments on the main and alternative limit proposals in Chapter 2 and assignment and subrogation in Chapter 4 of the CP. Respondents are requested to structure their responses by chapter.

1.22 The PRA will publish a statement of policy with a summary of the feedback, final rules and an updated statement of policy for the FSCS in 2015 H1.

## 2 Proposals on compensation limits

2.1 This chapter looks at changes required to ensure the limits for FSCS compensation reflect the PRA's objective of securing an appropriate degree of policyholder protection. The PRA considers that the compensation limits should be based on the significance to policyholders of the risk insured and the potential for significant adverse consequences for policyholders of cover being disrupted or obligations not paid.

2.2 Compensation is currently set at 100% cover for liabilities subject to certain compulsory insurance and 90% cover for all other insurance.<sup>(1)</sup> In contrast to deposit protection, there is no cap on the maximum amount of compensation.

2.3 The proposed approach maintains the two levels of cover. It recognises that some policyholders are more vulnerable to a sudden reduction of income which may affect their ability to

(1) The types of liability subject to compulsory insurance are defined in the Policyholder Protection Part in Appendix 1.

maintain a basic standard of living. In many cases, a policyholder is locked in to the product over many years and may face penalties for surrendering their policy. This limits their ability to find alternative cover for the same risks or to mitigate the loss of cover in other ways.

2.4 Further, some classes of insurance provide protection against significant risk. A sudden reduction of that cover or disruption to payments falling due under that cover could have a very material impact on the livelihoods of individuals or companies.

2.5 The current limits afford higher protection for certain liabilities subject to compulsory insurance. The proposals in this CP extend this higher level of protection for those products where:

- (i) the claim is made under a contract of professional indemnity insurance (which, in many cases, the policyholder is required to hold in order to undertake economic activity);
- (ii) the claim arises from death or incapacity due to injury, sickness, or infirmity of the policyholder; or
- (iii) benefits falling due are payable in the form of income or other regular payment.

2.6 Rules which outline the changes to the limits can be found in the Policyholder Protection Part in Appendix 1.

### Long-term insurance

2.7 The PRA intends to set the following revised limits for long-term insurance.

**2.8 Annuities (in the decumulation phase) and other forms of income:** the PRA proposes to increase the cover to 100% for annuities in payment and other benefits in the form of regular income. The long-term locked-in nature of annuities means that many policyholders have a lower capacity to protect themselves or seek alternative cover. Policyholders can, in particular, be dependent on annuity payments as part of their regular income and can be affected by any delays or missed payments. Further, a policyholder's situation and circumstances may have changed since taking out the policy and they may not be able to find alternative cover on the same terms, if at all.

2.9 Budget 2014 introduced new options for the purchase of annuities in retirement. The PRA anticipates that there may be product and market innovations following this but does not expect this to affect the application of the proposed rule as long as the product continues to pay benefits falling due in the form of income or other regular payments.

**2.10 Pensions (in the accumulation phase) and investment life savings:** the PRA proposes to maintain 90% cover for both pension life savings and investment life savings (wrapper products). These products are characterised by saving for the longer term or for retirement. While the product is in the accumulation phase and policyholders are not yet receiving income, policyholders are not yet dependent upon life savings policies to the extent that annuitants are, nor are they locked in over the long term to their policies to the same degree and so are not as vulnerable to a sudden reduction in income.

**2.11 Claims arising from death or incapacity (pure protection):** the PRA proposes to increase cover to 100% for claims arising from the death or incapacity of the policyholder. These pure protection long-term insurance products protect individual policyholders against acute events such as critical illness or protect their families in the event of their death. As with annuity products, policyholders with these insurance products are often locked in to a product for a long period and are reliant on payments, and so would be worse off following a sudden loss or reduction in payments. These individuals may also have a lower capacity to protect themselves or to seek alternative cover.

**2.12 Savings products with both a savings and protection element:** the PRA proposes to maintain 90% cover for the saving element, but to increase cover to 100% for the pure protection element. This aims to ensure that a death claim under an endowment policy, or other mixed policies, is treated the same regardless of whether the policy is a pure protection policy or a combined savings and protection policy. The PRA considers that protection for the savings element (when the policyholder is in the accumulation phase) should remain at 90% as the policyholder is not yet locked in and therefore not dependent on the policy to the same extent as policyholders that are claiming on the pure protection element (disability or death claim). Policyholders with savings products are likely to have a higher capacity to protect themselves and seek alternative cover.

### General insurance

2.13 The PRA proposes maintaining existing full coverage for certain liabilities relating to compulsory insurance. The 100% protection would also be extended to the following general insurance products.

**2.14 Claims arising from death or incapacity:** consistent with the approach to long-term insurance claims, general insurance claims arising from the death or incapacity of the policyholder under, for example, creditor, accident, sickness and unemployment insurance should also be covered at 100%. This reflects a policyholder's likely lessened ability to seek alternative cover and mitigate the risk in other ways.



**2.15 Professional indemnity insurance (PII):** PII is frequently a contractual requirement, required under legislation, or a condition imposed by a professional body to be maintained so that a person or firm can trade or undertake employment. The PRA considers that the market consequences of cover being withdrawn unexpectedly could be significant, if holders of PII stop trading or obligations due are not paid. The PRA's Insurance Approach Document also refers to a need to prioritise cover for this type of insurance.<sup>(1)</sup>

**2.16 Other general insurance classes:** the PRA proposes that the limit for other general insurance classes should be maintained at 90%. These products are generally short term in nature. This means that policyholders are not contractually locked in to the product over a long period of time so are typically less vulnerable to a sudden loss in income. Policyholders can exit the product without significant cost and can easily find alternative cover with another insurance provider to protect themselves for future risks should the insurer fail. Where policyholders hold insured claims, the policyholder may be reliant on the failed insurer to pay the claim, but is entitled to 90% of the value of the claim and can seek alternative cover if relevant.

### Alternative proposals — increasing limits for all insurance products and capping large claims

**2.17** The PRA considered, as an alternative, increasing limits for all long-term insurance to 100%. The benefits of this would include:

- (i) facilitating the delivery of the operational aspects of securing continuity and paying out claims for the FSCS. Higher compensation in payout would allow the FSCS to contribute more to facilitate the transfer to a new provider. This could make such a transfer more attractive commercially. It would also reduce the administrative and logistical costs of the FSCS since benefits, premiums and claim payments would not need to be altered; and
- (ii) simplifying cover and thus make it easier for policyholders to understand the extent to which they are covered.

**2.18** Balanced against these benefits this alternative approach does not take into account the variability in risks that a sudden disruption or removal of cover through different types of long-term insurance products pose to policyholders. In addition, this alternative approach would lead to higher costs for levy payers than the proposed approach.

**2.19** The PRA has also considered applying a cap on certain very large claims. The cap could be set at the lifetime pension relief allowance, ie £1.25 million from 2014/15, which is the current threshold set by HM Revenue & Customs for tax-free pension savings. Such a cap may not, however, be appropriate for certain types of claims such as in the case of claims relating

to critical illness. The cap also introduces additional operational complexity.

**2.20** Having considered the alternatives, the PRA concluded that the main proposal (varying the limits for different insurance products) presents the most appropriate proposal for advancing the PRA insurance objective, having regard to its regulatory principles.

### Economic impact

**2.21** FSMA requires the PRA to publish a CBA of the proposed rules. In particular, it requires the PRA to publish estimates of the costs and the benefits, unless these cannot reasonably be estimated or it is not reasonably practicable to produce an estimate.

**2.22** The analysis set out below covers the costs and benefits arising from changes in the FSCS protection limit for annuities, pure protection life policies, professional indemnity and claims arising from death or incapacity. The proposals will affect all insurance companies that offer these types of products. The PRA estimates, based on regulatory data from 2013, that at least 100 life insurers and 100 general insurers might be affected by the proposals to increase limits.

**2.23** The CBA considers incremental costs and benefits above the baseline of the current protection limit at 90%.

### Incremental benefit

**2.24** The proposals help enhance policyholder protection. Under the proposals, those affected policyholders will be able to receive 100% (rather than the current 90%) compensation in the event of the failure of the insurer.

### Direct cost to the PRA and the FSCS

**2.25** Direct costs to the PRA arising from the proposals are expected to be minimal and should be absorbed into the general operational costs of the PRA.

**2.26** The FSCS has not identified any increases in costs. In the event of a large failure, however, additional costs could be incurred if any cost arising as a consequence of changes to the level of protection proved to outweigh benefits from proposals aimed at improving the operational efficiency of the FSCS.

### Compensation costs

**2.27** The PRA does not expect firms to incur any direct compliance costs due to the proposals. Firms will face increased compensation costs in the event of an insurer failing, though the extent of this will depend on the probability of failure. Assuming the proposals do not affect the probability of failure directly, such an increase in compensation costs will

(1) See footnote 4, page 3.



equal 10% of the value of the liability of an insurer to the claimant under the relevant protected contract.

2.28 The PRA has estimated the expected increase in compensation costs based on the average of previous FSCS compensation payments for general insurance provisions and life and pension provisions from 2008 until 2013.<sup>(1)</sup> The average annual increase in compensation for general and life and pension insurance provision is estimated to be approximately £7 million from 2008 to 2013.

2.29 Again, subject to no direct changes to firms' likelihood of failure, the estimated increase in costs is an upper bound as it assumes that the limit for all products increases to 100%, rather the proposed approach which retains 90% compensation in some cases.

2.30 Any increase in the compensation costs will be levied on insurance companies via FSCS levies.

### Impact on mutuals

2.31 The proposal will affect small friendly societies. The costs however, are not expected to be substantially different from the costs incurred by other insurance companies in the same category.

### Impact on competition

2.32 The PRA does not expect the proposals to have any impact on competition.

## 3 Successor firms

3.1 This chapter sets out the proposed PRA approach for the protection of policyholders of successor firms, ie firms (whether a PRA-authorized insurer or not) that have assumed the liabilities of a predecessor relevant person. Relevant persons are those insurers that are PRA-authorized insurers against which an eligible claimant has a valid claim. Rules on this can be found in the Policyholder Protection Part in Appendix 1. The statement of policy in Appendix 3 sets out the PRA's expectations with regard to successor firms.

### Compensation arrangements for successor firms

3.2 The proposals are intended to set out how protection applies to successor firms that have assumed liabilities from predecessor relevant persons. The PRA is required under section 213(1)(b) of FSMA to provide protection for policyholders of persons who have assumed responsibility for liabilities arising from acts or omissions of predecessor relevant persons, in circumstances where the successor firm is unable, or likely to be unable, to satisfy protected claims against it.

3.3 The PRA proposes to provide protection for policyholders who have a protected claim against a predecessor relevant

person, where the insured event which gave rise to the claim occurred before the transfer under which the liabilities were assumed by the successor firm.

3.4 Policies are not within the scope of protection where the insured event that gave rise to the claim occurs after the transfer under which the liabilities were assumed by the successor firm. This is because the scheme can only cover claims against a successor firm based on the acts or omissions of a predecessor that is a relevant person. This means that the policyholder must have had a claim (whether reported or unreported) against a predecessor relevant person before the successor firm assumed the liabilities.

3.5 Claims that arise (whether reported or unreported) after a transfer of liabilities to a successor firm will only be covered by the FSCS if the firm assuming the liabilities is, itself, a PRA-authorized insurer and is, as such, a relevant person under the Policyholder Protection Part.

## 4 Operational changes for the FSCS

4.1 The recommendations in this chapter aim to address operational issues facing the FSCS following an insurer being declared in default. Rules on these policy proposals can be found in the Policyholder Protection Part in Appendix 1.

### Automatic assignment, electronic assignment and automatic subrogation of policyholder rights to the FSCS

4.2 The current compensation scheme rules empower the FSCS to determine that payment of compensation should have the effect of automatically subrogating the FSCS to the rights that claimants may have against a relevant person or other third parties but these provisions do not apply in respect of claims under protected contracts of insurance. They also currently oblige the FSCS to make any payment of compensation in respect of claims under protected contracts of insurance conditional upon the claimant assigning their rights against the relevant person or against any third parties to the FSCS.

4.3 The PRA proposes giving the FSCS the power to provide that the payment of compensation by the FSCS shall have the effect of automatically subrogating the FSCS to the claimant's rights against the insurer, a successor and/or against any third parties as an alternative to assignment. The PRA also proposes a rule whereby a payment of compensation has the effect of automatically assigning the claimants rights against insurers, successors and other third parties to the FSCS and to make provision for the electronic assignment of rights in the PRA's Policyholder Protection Part. These powers may be used

(1) FSCS Annual Reports; [www.fscs.org.uk/industry/publications/annual-reports/](http://www.fscs.org.uk/industry/publications/annual-reports/).

separately or in combination, depending on circumstances and should enable the FSCS to maximise its operational efficiency.

4.4 Automatic subrogation describes a process whereby the FSCS steps into the shoes of the policyholder and takes over all or part of their rights to pursue recoveries against insurers, successors or other third parties. The FSCS can currently determine that automatic subrogation should apply in relation to protected depositors and the PRA proposes giving the FSCS similar powers in respect of policyholders.

4.5 Assignment allows the FSCS to claim as a creditor in its own right in an insolvency proceeding, such as liquidation or administration, and seek to recover the amount which the FSCS has paid to the policyholder. Automatic assignment will enable this to occur without the FSCS being required to undergo the significant administrative burden of obtaining individual deeds of assignment from each policyholder. The FSCS should notify a claimant where automatic assignment applies.

4.6 The PRA also proposes giving the FSCS the ability to obtain assignment by electronic means. The FSCS already has, and would retain, the power to obtain assignment by writing. Electronic assignment would allow claimants to assign their rights against an insurer, successor or third party to the FSCS online or via email, as opposed to assignment in writing where a claimant must submit a written form, signed by hand.

4.7 By expanding the range of options available to the FSCS to secure a right of recovery against insurers, successors or other third parties when making payments of compensation to claimants, the PRA is seeking to give the FSCS flexibility to pursue the most operationally effective strategy in the given circumstances. However, the PRA recognises that concepts such as 'subrogation' and 'assignment', which are used in both the current and proposed rules, are quite technical and can sometimes be conflated. FSMA does not expressly require the PRA to adopt these concepts in making rules for the scheme and the PRA has considered whether using simpler language in its rules (for example, 'transfer') to achieve the same substance might be desirable. Respondents views on this point are particularly welcome.

### **Economic impact**

4.8 Automatic subrogation, automatic assignment and electronic assignment would improve the operational efficiency of the FSCS. The proposals would support claims handling and potentially reduce costs to the FSCS from being required to obtain policyholders' signatures and processing claims. Any such efficiency savings would be passed on to firms through reduced FSCS levies.

### **Flexibility in verifying scope**

4.9 The FSCS is presently allowed to pay compensation without fully investigating the eligibility, validity or amount of the claim provided: (i) it is not readily apparent that a contract falls outside the FSCS's scope; and (ii) the costs and delay involved in verifying the position are likely to be disproportionate. The PRA proposes to also allow the FSCS to treat an insurance contract as protected without fully investigating the eligibility of the claimant, validity or amount of the claim, when seeking or securing continuity, or when the FSCS is taking measures to safeguard the rights of eligible claimants. Without this discretion, the task of checking the eligibility or validity of claims could lead to undue delay following a default, potentially disrupting continued payment of benefits on which policyholders are reliant.

### **FSCS cover where trustees are located overseas or joint policyholders live in different countries**

4.10 The PRA proposes to clarify how the eligibility criteria for determining the location of the risk or commitment relating to an insurance contract apply in circumstances where the policy is held on trust or held by two or more joint policyholders.

4.11 Under the current COMP rules, the risk or commitment under an insurance contract is situated:

- (i) in the case of individuals, where that individual had his or her habitual residence when the contract commenced; and
- (ii) in the case of non-individuals (for example, bodies corporate), where the establishment to which the risk or commitment relates is situated.

4.12 A trust (and in particular one with multiple trustees) does not sit comfortably within this test. As such, the PRA proposes to clarify that an insurance policy is protected if at least one of the trustees meets the protection criteria in (i) above if the trustee is an individual; or (ii) above if it is a corporate trustee.

4.13 Further, where there are two or more policyholders, only one of the policyholder's habitual residences is required to meet the protection criteria. This removes prolonged uncertainty for policyholders whose payments may be held up due to a lack of clarity in the FSCS eligibility criteria.

### **FSCS power to require information**

4.14 The PRA proposes to extend the current scope of the FSCS power to require information from insurers. The rules currently allow the FSCS to require information from firms when they have been declared in default. The PRA considers that this should be extended to include situations where the firm is in financial difficulty or where the FSCS is seeking to secure continuity of cover, for example, through a transfer of business or issue of policies by another firm.

4.15 Giving the FSCS the ability to collect information in these circumstances will assist in the fair determination of claims and the FSCS's ability to assist in securing continuity by paying benefits falling due for insurance contracts.

### **Economic impact**

4.16 The PRA does not expect firms to incur additional costs from providing information to the FSCS as they currently already provide this information to the PRA. The transfer of the ability to require such information directly should not increase costs in itself. Direct access to information should make the process of assessing eligibility more efficient, speeding up payout for claimants.

## **5 Funding**

5.1 The revised Fees sourcebook will comprise separate funding rules for deposit and insurance compensation. CP20/14 sets out the Management Expenses Levy Limit and Base Costs Part and Management Expenses in respect of Relevant Schemes Part. These also apply to PRA-authorized insurers, the FSCS and the Society of Lloyd's.

5.2 This chapter sets out changes to the calculation of compensation costs.

### **Clarification of insurance compensation costs**

5.3 The PRA is proposing to clarify the definition of the relevant net premium income and make one small amendment to the application of the general insurance (Class B1) and long-term insurance (Class C1) calculations for the FSCS compensation costs levy set out in the Policyholder Protection Part in Appendix 1.

5.4 The PRA is proposing to amend the definition of relevant net premium income used in the compensation cost calculation for general insurers and long-term insurers by introducing an option giving insurers the ability to base their

calculation on the number of contracts held by eligible claimants. Insurers are currently required to calculate their levy for premium income based on relevant net premium income. Relevant net premium income is defined as premium income relating to protected contracts of insurance but does not consider the eligibility of the claimants. Should an insurer fail, the FSCS is only required to protect those contracts that relate to protected contracts with eligible claimants. Therefore it is proposed to amend the compensation cost calculation to give insurers the option to align the levy allocation more closely with the business potentially giving rise to a compensation cost. The FSCS would only pay out to a wider set of policyholders if it chooses to treat a contract of insurance as protected without fully investigating the eligibility or validity of the claim (as set out in the flexibility in verifying scope section in Chapter 4 of this CP).

5.5 When Solvency II comes into effect, certain provisions will affect how firms calculate their FSCS levy under Chapter 21 of the Policyholder Protection Part. The PRA will need to make amendments to Chapter 21 to take account of these changes, and intends to consult on a set of proposals in 2015 once the reporting requirements under Solvency II are clearer. As part of that revision, the PRA also intends to address a number of small inconsistencies in the calculation mainly relating to the cross reference in FEES 6 tariff (FSCS calculation) to FEES 4 Annex 1B (regulatory fee calculation).

### **Economic impact**

5.6 The PRA does not hold sufficient data to assess the incremental change in the number of eligible policyholders, and thus the quantitative impact of the proposals. This proposal is a clarification of how levies should be calculated and aligns the approach used more closely with liabilities giving rise to potential compensation cost. This does not affect actual compensation cost to the industry, though it may affect allocation of costs.

# Appendices

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- 1 Draft Rules — Policyholder Protection Part

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  - 2 Draft Rules — Lloyd's Part

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  - 3 Draft Statement of Policy – The PRA's expectations on the FSCS (Policyholder Protection)

**PRA RULEBOOK SOLVENCY II FIRMS; NON SOLVENCY II FIRMS; NON-AUTHORISED PERSONS: POLICYHOLDER PROTECTION INSTRUMENT [YEAR]**

**Powers exercised**

- A. The Prudential Regulation Authority (“PRA”) makes this instrument in the exercise of the following powers and related provisions in The Financial Services and Markets Act 2000 (“the Act”), The Compensation Act 2006 (Contribution for Mesothelioma Claims) Regulations 2006 (“the mesothelioma regulations”) and The Financial Services and Markets Act 2000 (Transitional Provisions, Repeals and Savings) (Financial Services Compensation Scheme) Order 2001 (“the compensation transitionals order”):
- (1) section 137G (The PRA’s general rules) of the Act;
  - (2) section 137T (General supplementary powers) of the Act;
  - (3) section 213 (The compensation scheme) of the Act;
  - (4) section 214 (General) of the Act;
  - (5) section 215 (Rights of the scheme in insolvency) of the Act;
  - (6) section 216 (Continuity of long-term insurance policies) of the Act;
  - (7) section 217 (Insurers in financial difficulties) of the Act;
  - (8) section 218 (Annual Report) of the Act;
  - (9) section 218A (Regulators power to require information) of the Act;
  - (10) section 219 (Scheme manager’s power to require information) of the Act;
  - (11) section 223 (Management expenses) of the Act;
  - (12) article 9 (Article 9 defaults occurring before commencement) of the compensation transitionals order;
  - (13) article 9A (Contributions in relation to mesothelioma claims) of the compensation transitionals order;
  - (14) article 10 (Applications in respect of compulsory liability insurance) of the compensation transitionals order;
  - (15) article 12 (Applications under the new scheme) of the compensation transitionals order; and
  - (16) article 3 (Further power for Authority to make rules concerning mesothelioma claims) and 4 (Modification of FSMA in relation to FSA rules for mesothelioma claims) of the mesothelioma regulations.
- B. The rule-making powers referred to above and related provisions are specified for the purpose of section 138G(2) (Rule-making instrument) of the Act and the compensation transitionals order.

**Pre-conditions to making**

- C. In accordance with section 138J of the Act (Consultation by the PRA), the PRA consulted the Financial Conduct Authority. After consulting, the PRA published a draft of proposed rules and had regard to representations made.

**PRA Rulebook Solvency II Firms; Non-Solvency II Firms; Non-Authorised Persons: Policyholder Protection Instrument [Year]**

- D. The PRA makes the rules in the Annexes A and B to this instrument.

**Commencement**

- E. This instrument comes into force on [DATE].

**Citation**

- F. This instrument may be cited as the PRA Rulebook Solvency II Firms; Non-Solvency II Firms; Non-Authorised Persons: Policyholder Protection Instrument [Year].

**By order of the Board of the Prudential Regulation Authority**  
[DATE]

**Annex A**

Insert the following new definitions (in the appropriate alphabetical position) into the Glossary Part of the PRA Rulebook:

*aircraft*

means the class of *contract of insurance*, specified in paragraph 5 of Part I of Schedule 1 to the *Regulated Activities Order*.

*aircraft liability*

means the class of *contract of insurance*, specified in paragraph 11 of Part I of Schedule 1 to the *Regulated Activities Order*.

*authorised contractual scheme*

means a *co-ownership scheme* or a *partnership scheme*.

*byelaw*

means any Byelaw, direction, regulation, or other instrument made using the powers of the *Council* under section 6 of Lloyd's Act 1982 (including any regulation ratified by the *Council* by special resolution) and any condition or requirement made under any such Byelaw, direction, regulation or other instrument.

*Central Fund*

means the Central Fund established under Lloyd's Central Fund Byelaw (No 4 of 1986) and the New Central Fund established under Lloyd's New Central Fund Byelaw (No 23 of 1996).

*compensation scheme*

means the Financial Services Compensation Scheme established under section 213 of *FSMA*.

*contract of insurance*

has the meaning given in article 3(1) of the *Regulated Activities Order*.

*FSCS*

means the *body corporate* established under section 212 of *FSMA* to administer the *compensation scheme*.

*goods in transit*

means the class of *contract of insurance* specified in paragraph 7 of Part I of Schedule 1 to the *Regulated Activities Order*.

*ICVC*

means a body incorporated under the Open-Ended Investment Companies Regulations 2001(SI 2001/1228).

*incorporated friendly society*

means a society incorporated under the Friendly Societies Act 1992.

*liability of ships*

means the class of *contract of insurance*, specified in paragraph 12 of Part I of Schedule 1 to the *Regulated Activities Order*.

*mutual*

means an *insurer* which:

- (1) if it is a *body corporate* has no *share* capital (except a wholly owned *subsidiary undertaking* with no *share* capital but limited by guarantee);
- (2) is a *registered friendly society* or *incorporated friendly society*; or
- (3) is a society registered or deemed to be registered under the Industrial and Provident Societies Act 1965 or the Industrial and Provident Societies (Northern Ireland) Act 1969.

*policy*

has the meaning given in article 2 of the Financial Services and Markets Act 2000 (Meaning of "Policy" and "Policyholder") Order 2001 (SI 2001/2361).

*policyholder protection scheme*

means the *compensation scheme* for claims under *contracts of insurance*.

*premium*

means the consideration payable under a *contract of insurance* by the *policyholder* to the *insurer*.

*recognised scheme*

means a scheme recognised under:

- (1) section 264 of *FSMA* (Schemes constituted in other EEA States);
- (2) section 270 of *FSMA* (Schemes authorised in designated countries or territories); or
- (3) section 272 of *FSMA* (Individually recognised overseas schemes).

*registered friendly society*

means a *friendly society* registered under section 7(1)(a) of the Friendly Societies Act 1974 or any enactment which it replaced, including any registered branches.

*regulated collective investment scheme*

means:

- (1) an *ICVC*;
- (2) an *authorised unit trust scheme*;
- (3) an *authorised contractual scheme*; or



(4) a *recognised scheme*.

*share*

means the investment specified in article 76 of the *Regulated Activities Order*.

*ships*

means the class of *contract of insurance* specified in paragraph 6 of Part I of Schedule 1 to the *Regulated Activities Order*.

*waiver*

means a direction waiving or modifying a *rule* given by the *PRA* under section 138A of *FSMA* (Modification or waiver of rules).

**Annex B**

In this Annex, the text is all new and is not underlined.

**Part**

# **POLICYHOLDER PROTECTION**

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**Chapter content**

- 1. APPLICATION AND DEFINITIONS**
- 2. FSCS**
- 3. QUALIFYING CONDITIONS FOR PAYING COMPENSATION**
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- 7. ELIGIBLE CLAIMANTS**
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## 1 APPLICATION AND DEFINITIONS

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1.1 This Part applies to the *FSCS*, and for the purposes of chapter 21 only, this Part also applies to *participant firms* and the *Society*.

1.2 In this Part, the following definitions shall apply:

*AIFM*

means *alternative investment fund manager*.

*alternative investment fund manager*

means (in accordance with article 4(1)(b) of *alternative investment fund managers directive*) a legal person whose regular business is performing *AIFM investment management functions* for one or more *AIF*.

*AIFM investment management functions*

means investment management functions of an *AIFM* as set out in 1(a) (portfolio management) or (b) (risk management) of Annex I to *alternative investment fund managers directive*.

*article 9 default*

has the meaning given in article 2(2) of the *compensation transitionals order*.

*authorised insurance company*

means (in accordance with the *compensation transitionals order*) a person who was, at any time before *commencement*, authorised under section 3 or 4 of the Insurance Companies Act 1982 to carry on insurance business of any class in the *United Kingdom*.

*base costs*

means *management expenses* which are not attributable to any *insurance class*.

*base costs levy*

means a levy, forming part of the *management expenses levy*, to meet the *base costs* in the financial year of the *compensation scheme* to which the levy relates, each *participant firm's* (and, where applicable, the *Society's*) share being calculated in accordance with the *FSCS Management Expenses Levy Limit and Base Costs Part*.

*claim*

means a valid claim made in respect of a civil liability:

- (1) owed by a *relevant person*; or
- (2) owed by a *relevant person* which has been assumed by a *successor* and which is based on the acts or omissions of the *relevant person*;

under a *contract of insurance*.

*compensation costs*

means the costs incurred:

- (1) in paying compensation in accordance with this Part;
- (2) as a result of making the arrangements contemplated in 4.1 or 4.3 or taking the measures contemplated in 5.1; or
- (3) in making payments or giving indemnities under 18.2.

*compensation costs levy*

means a levy imposed by the FSCS on *participant firms* to meet *compensation costs*, each *participant firm's* share being calculated in accordance with 21.37 – 21.41.

*compensation transitionals order*

means the Financial Services and Markets Act 2000 (Transitional Provisions, Repeals and Savings) (Financial Services Compensation Scheme) Order 2001 (SI 2001/2967).

*credit*

means the class of *contract of insurance*, specified in paragraph 14 of Part I of Schedule 1 to the *Regulated Activities Order*.

*depository*

has the meaning given to it in regulation 2 of the Alternative Investment Fund Managers Regulations 2013.

*directive friendly society*

means a *friendly society* other than a *non-directive friendly society*.

*eligible claimants*

means a *person* who is eligible to bring a *claim* for compensation under 7.1.

*friendly society*

means an *incorporated friendly society* or a *registered friendly society*.

*habitual residence*

means:

- (1) if the *policyholder* is an individual, the address given by the *policyholder* as his residence if it reasonably appears to be a residential address and there is no evidence to the contrary;
- (2) if the *policyholder* is not an individual or a group of individuals, the State in which the *policyholder* has its place of establishment, or, if it has more than one, its relevant place of establishment; or
- (3) in respect of the variation of a *life policy*, or the purchase of a *pension annuity* related to a *life policy*, unless there is evidence to the contrary, the habitual

residence of the *policyholder* at the date on which the *policyholder* signed the proposal for the *life policy*.

*holding company*

has the meaning given to it in section 1159(1) of the Companies Act 2006 (Meaning of “subsidiary” etc).

*in default*

means the status of being in default following a determination under 10.2 for a *relevant person* (or where applicable, under 11.2 for a *successor*).

*insurance class*

means one of the classes set out in Annex 1.

*investment*

means (in accordance with sections 22(4) of *FSMA* (Regulated activities) and section 93(2) of the Financial Services Act 2012) any investment, including any asset, right or interest.

*large company*

means a *body corporate* which does not qualify as a small company under section 247 of the Companies Act 1985, or section 382 of the Companies Act 2006 as applicable.

*large mutual association*

means an unincorporated mutual association or an unincorporated association (which is not a mutual association) with net assets of more than £1.4 million (or its equivalent in any currency at the relevant time).

*large partnership*

means a *partnership* with net assets of more than £1.4 million (or its equivalent in any other currency at the relevant time).

*levy limit*

means the maximum aggregate amount of *compensation costs* and *specific costs* that may be allocated to a particular *insurance class* in one financial year as set out in Annex 1.

*liability subject to compulsory insurance*

means any liability required under any of the following enactments to be covered by insurance or (as the case may be) by some other provisions for securing its discharge:

- (1) section 1(4A)(d) of the Riding Establishments Act 1964 (or any corresponding enactment for the time being in force in Northern Ireland);

- (2) section 1 of the Employers' Liability (Compulsory Insurance) Act 1969 or Article 5 of the Employers' Liability Order (Defective Equipment and Compulsory Insurance) (Northern Ireland) Order 1972;
- (3) Part VI of the Road Traffic Act 1988 or Part VIII of the Road Traffic (Northern Ireland) Order 1981;
- (4) section 19 of the Nuclear Installations Act 1965.

*life policy*

means (in accordance with the definition of a 'qualifying contract of insurance' in article 3(1) of the *Regulated Activities Order*) a *contract of long-term insurance* (other than a reinsurance contract and a *pure protection contract*) and a *long-term care insurance contract*.

*limited liability partnership*

means:

- (1) a *body corporate* incorporated under the Limited Liability Partnerships Act 2000;
- (2) a *body corporate* incorporated under legislation having the equivalent effect to the Limited Liability Partnerships Act 2000.

*Lloyd's policy*

means a *contract of insurance* written at Lloyd's.

*long-term care insurance contract*

means a *contract of long-term insurance*:

- (1) which provides, would provide at the *policyholder's* option, or is sold or held out as providing, benefits that are payable or provided if the *policyholder's* health deteriorates to the extent that he cannot live independently without assistance and that is not expected to change; and
- (2) under which the benefits are capable of being paid for periodically for all or part of the period that the *policyholder* cannot live without assistance;

where 'benefits' are services, accommodation or goods necessary or desirable for the continuing care of the *policyholder* because he cannot live independently without assistance.

*management expenses*

means (in accordance with section 223 of *FSMA* (Management expenses)) expenses incurred or expected to be incurred by the *FSCS* in connection with its function under *FSMA*, other than *compensation costs* and costs incurred under Part 15A of *FSMA*.

*management expenses levy*

means a levy imposed by the *FSCS* on *participant firms* to meet the *management expenses* and which is made up of one or more of a *base cost levy* and a *specific*

*costs levy*, each *participant firm's* share being calculated in accordance with 21.28 – 21.35.

*mesothelioma regulations*

means The Compensation Act 2006 (Contribution for Mesothelioma Claims) Regulations 2006 (SI 2006/3259).

*mesothelioma victim*

means (in accordance with section 3 (1) of the Compensation Act 2006) a *person* who has contracted mesothelioma as a result of exposure to asbestos by a *responsible person*.

*money laundering*

means any act which:

- (1) constitutes an offence under section 18 (Money laundering) of the Terrorism Act 2000;
- (2) constitutes an offence under section 327 (Concealing etc), section 328 (Arrangements) or section 329 (Acquisition, use and possession) of the Proceeds of Crime Act 2002;
- (3) constitutes an attempt, conspiracy or incitement to commit an offence specified in paragraph (b);
- (4) constitutes aiding, abetting, counselling or procuring the commission of an offence specified in paragraph (b); or
- (5) would constitute an offence specified in paragraph (b), (c), or (d) if done in the *United Kingdom*.

*money-purchase benefits*

means in relation to a member of a *personal pension scheme* or an *occupational pension scheme* or the widow or widower or surviving civil partner of a member of such a scheme, benefits the rate or amount of which is calculated by reference to a payment or payments made by the member or by any other *person* in respect of the member and which are not average salary benefits.

*nominee company*

means a *body corporate* whose business consists solely of acting as a nominee holder of *investments* or other property.

*non-directive friendly society*

means

- (1) a *friendly society* whose *insurance business* is restricted to the provision of benefits which vary according to the resources available and in which the contributions of the members are determined on a flat-rate basis;
- (2) a *friendly society* whose *long-term insurance business* is restricted to the provision of benefits for employed and self-employed *persons* belonging to



an undertaking or group of undertakings, or a trade or group of trades, in the event of death or survival or of discontinuance or curtailment of activity (whether or not the commitments arising from such operations are fully covered at all times by mathematical reserves);

- (3) a *friendly society* which undertakes to provide benefits solely in the event of death where the amount of such benefits does not exceed the average funeral costs for a single death or where the benefits are provided in kind;
- (4) a *friendly society* (carrying on *long-term insurance business*):
  - (a) whose registered rules contain provisions for calling up additional contributions from members or reducing their benefits or claiming assistance from other *persons* who have undertaken to provide it; and
  - (b) whose annual gross premium income (other than from contracts of reinsurance) has not exceeded 5 million Euro for each of the three preceding financial years;
- (5) a *friendly society* (carrying on *general insurance business*):
  - (a) whose registered rules contain provisions for calling up additional contributions from members or reducing their benefits;
  - (b) whose gross premium income (other than from contracts of reinsurance) for the preceding financial year did not exceed 5 million Euro; and
  - (c) whose members provided at least half of that gross premium income;
- (6) a *friendly society* whose liabilities in respect of *contracts of general insurance* are fully reinsured with or guaranteed by other *mutuals* (including *friendly societies*); and the *mutuals* providing the *reinsurance* or the *guarantee* are subject to the rules of the *First Non-Life Directive*,

and in each case whose *insurance business* is limited to that described in any of (1) to (6);

*occupational pension fund management business*

means the business of carrying on:

- (1) *pension fund management*;
- (2) (other than in connection with a *personal pension scheme*) *pension fund management* written as linked long-term business, for an *occupation pension scheme* or for an institution falling within article 2 of the Council Directive of 3 June 2003 on the activities and supervision of institution for occupation retirement provision (No 2003/43/EC), but only to the extent that:
  - (a) there is no transfer to the *participant firm* of:
    - (i) investment, market or credit risk;
    - (ii) mortality or expense risk prior to any annuity being effected; and

- (b) any annuity options provide for the *participant firm* to change the annuity rates without prior notice.

*occupational pension scheme*

means a scheme specified in article 3(1) of the *Regulated Activities Order* (Interpretation) which is, in summary, a pension scheme established for the purpose of providing benefits to people with service in employments of a prescribed description.

*overseas financial services institution*

means an institution authorised to carry on any *regulated activity* or other financial service by an *overseas regulator*.

*operator*

means (in relation to a *personal pension scheme* or a *stakeholder pension scheme*) the *person* who carries on the regulated activity specified in article 52 of the *Regulated Activities Order* (Establishing a pension scheme etc).

*participant firm*

means a *firm* which is an *insurer* or (except for the purposes of 21) a *member*.

*pension annuity*

means an *investment* purchased with the sums derived from the vesting (partial or full) of a *pension policy* or *pension contract*, for the purposes of securing the beneficiary's entitlement to immediate or future benefits.

*pension contract*

means a contract under which rights to benefits are obtained by the making of contributions to an *occupational pension scheme* or to a *personal pension scheme*, where the contributions are paid to a *regulated collective investment scheme*.

*pension fund management*

means in relation to a class of *contract of insurance* the class of *contract of insurance* specified in paragraph VII of Part II of Schedule 1 to the *Regulated Activities Order* (Contracts of long-term insurance).

*pension policy*

means a contract under which a right to benefits results from contributions made to an *occupational pension scheme* or to a *personal pension scheme*, where the contributions are paid to a *long-term insurer*.

*pension scheme*

means a scheme under which a right to benefits results from contributions made under a *pension contract* or *pension policy*.

*personal pension scheme*

means a scheme or arrangement which is not an *occupational pension scheme* or *stakeholder pension scheme* and which is comprised in one or more instruments or agreements having or capable of having effect so as to provide benefits to or in respect of people:

- (1) on retirement;
- (2) on having reached a particular age; or
- (3) on termination of service in an employment.

*policyholder*

means (as defined in article 3 of the Financial Services and Markets Act 2000 (Meaning of "Policy" and "Policyholder") Order 2001 (SI 2001/2361)) the *person* who for the time being is the legal holder of the *policy*, including any *person* to whom, under the *policy*, a sum is due, a periodic payment is payable or any other benefit is to be provided or to whom such a sum, payment or benefit is contingently due, payable or to be provided.

*protected claim*

means a *claim* which is covered by the *policyholder protection scheme* as defined in 9.1.

*professional indemnity insurance*

means *contracts of insurance*, including directors' and officers' liability and error and omissions liability, against the risks of the persons insured incurring liabilities to third parties arising from wrongful acts (such as breach of duty, breach of trust, negligence, error or omissions) by professionals, named individuals or businesses occurring in the course of the insured's professional activities.

*protected contract of insurance*

means a *contract of insurance* which is covered by the *policyholder protection scheme* as defined in 9.2.

*pure protection contracts*

means:

- (1) a *contract of long-term insurance* in respect of which the following conditions are met:
  - (a) the benefits under the contract are payable only on death or in respect of incapacity due to injury, sickness or infirmity;
  - (b) the contract has no surrender value, or the consideration consists of a single premium and the surrender value does not exceed that premium; and
  - (c) the contract makes no provision for its conversion or extension in a manner which would result in it ceasing to comply with (a) or (b); or
- (2) a *reinsurance contract* covering all or part of a risk to which a *person* is exposed under a *contract of long-term insurance*.

*quantification date*

means the date as at which the liability of the *relevant person in default* is to be determined under 19.8 – 19.10.

*reinsurance contract*

means a *contract of insurance* covering all or part of a risk to which a *person* is exposed under a *contract of insurance*.

*relevant general insurance contract*

means any *contract of general insurance* other than a contract falling within any of the following classes:

- (1) aircraft;
- (2) ships;
- (3) goods in transit;
- (4) aircraft liability;
- (5) liability of ships; or
- (6) credit.

*relevant net premium income*

means:

- (1) (in relation to business which is not
- (2) ) either (at the election of the *firm*):
  - (a) the premium income in respect of *protected contracts of insurance* of a *firm*; or
  - (b) the premium income in respect of *protected contracts of insurance* with *eligible claimants* of a *firm*; or
- (2) (in relation to *occupational pension fund management business*) the *remuneration* retained by a *firm* in relation to its carrying on *occupational pension fund management business*;

in the year preceding that in which the date for submission of the information under 21.44 falls, net of any relevant rebates or refunds.

*relevant person*

means a *person* for *claims* against whom the *policyholder protection scheme* provides cover, as defined in 10.1.

*remuneration*

means any form of remuneration, including salaries, discretionary pension benefits and benefits of any kind.

*responsible person*

means (in accordance with section 3(1) of the Compensation Act 2006) a *person* who has negligently or in breach of statutory duty caused or permitted another *person* to be exposed to asbestos (including an *insurer* of such a *person*).

*small business*

means a *partnership, body corporate*, unincorporated association or mutual association with an annual turnover of less than £1 million (or its equivalent in any other currency at the relevant time).

*small self-administered scheme*

means an *occupational pension scheme* of a kind described in article 4(4) or 4(5) of the Financial Services and Markets Act 2000 (Carrying on Regulated Activities by Way of Business) Order 2001 (SI 2001/1177).

*specific costs*

means *management expenses* other than *base costs*.

*specific costs levy*

a levy, forming part of the *management expenses levy*, to meet the *specific costs* in the financial year of the *compensation scheme* to which the levy relates, each *participant firm's* share being calculated in accordance with 21.34.

*stakeholder pension scheme*

means a scheme that meets the conditions in section 1 of the Welfare Reform and Pensions Act 1999 or article 3 of the Welfare Reform and Pensions (Northern Ireland) Order 1999.

*successor*

means a *person* for *claims* against whom the *policyholder protection scheme* provides cover, as defined in 11.1.

## **2 FSCS**

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- 2.1 The FSCS must administer the *policyholder protection scheme* in accordance with the *rules* in this Part, the *FSCS Management Expenses Levy Limit and Base Costs Part*, the *Management Expenses in Respect of Relevant Scheme Part*, and any other *Part* of the *PRA Rulebook* prescribed by law to ensure that the *policyholder protection scheme* is administered in a manner that is procedurally fair and in accordance with the European Convention on Human Rights.
- 2.2 The FSCS must publish information for claimants and potential claimants on the operation of the *policyholder protection scheme*.
- 2.3 The FSCS may agree to pay the reasonable costs of an *eligible claimant* bringing or continuing insolvency proceedings against a *relevant person* (whether those proceedings began before or after a determination of default), if the FSCS is satisfied that those proceedings would help it to discharge its functions under the requirements of this Part.

- 2.4 The FSCS must have regard to the need to use its resources in the most efficient and economic way in carrying out its functions under the requirements of this Part.
- 2.5 The FSCS must take appropriate steps to ensure that potential claimants are informed of how they can make a *claim* for compensation as soon as possible after a determination has been made that a *relevant person* (or where applicable, a *successor*) is *in default*, whether by the FSCS or the PRA.
- 2.6 The FSCS must put in place and publish procedures which satisfy the minimum requirements of procedural fairness and comply with the European Convention on Human Rights for the handling of any complaints of maladministration relating to any aspect of the operation of the *policyholder protection scheme*.
- 2.7 Notwithstanding anything to the contrary in this Part in relation to the *Society*, *members* and *Lloyd's policies*, the FSCS must act, so far as is reasonably practicable, to ensure that:
- (1) *eligible claimants* have protection under this Part in relation to *Lloyd's policies* equivalent to that otherwise afforded to *eligible claimants* by the FSCS;
  - (2) the FSCS does not meet *claims* in relation to *Lloyd's policies* unless the *Central Fund* is unlikely to be able to meet them;
  - (3) *claims* against *members* under the *policyholder protection scheme* which arise from the same loss under the same *Lloyd's policy* must be treated as a single *claim*; and
  - (4) any recovery resulting from the exercise of any subrogation or assignment of rights to the FSCS, is treated by the FSCS in accordance with 14.1 – 14.6, and any such recovery which is not paid to the claimant in accordance with those rules, is used for the benefit of FSCS in priority to any interest that the *Society* may have.
- 2.8 For the purposes of sections 219(1A)(b) and (d) of FSMA (Scheme manager's power to require information), whether a *relevant person* (or where applicable, a *successor*) is unable or likely to be unable to satisfy claims, shall be determined by reference to whether:
- (1) the *relevant person* (or where applicable, the *successor*) is *in default*;
  - (2) the FSCS has secured, or is attempting to secure, continuity of *contracts of long-term insurance* for *policyholders* of the *relevant person* in accordance with 4.1;
  - (3) the FSCS has made, or is considering making, a payment to *policyholders* of the *relevant person* in accordance with 4.3; or
  - (4) the FSCS has taken, or is considering taking, measures for the purposes of safeguarding the rights of *policyholders* of the *relevant person* in accordance with 5.1.

### 3 QUALIFYING CONDITIONS FOR PAYING COMPENSATION

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- 3.1 The FSCS may pay compensation to an *eligible claimant*, subject to 18, if it is satisfied that:
- (1) an *eligible claimant* has made an application for compensation (or falls within the category of persons referred to in 3.2);
  - (2) the claim is in respect of a *protected claim* against a *relevant person* (or where applicable, a *successor*) who is *in default*;
  - (3) where the FSCS so:

- (a) requires, the claimant has assigned the whole or any part of his rights under the *protected contract of insurance* against the *relevant person* (or where applicable, a *successor*) or against any third party to the *FSCS*, on such terms as the *FSCS* thinks fit; and/or
  - (b) determines, the claimant has immediately and automatically subrogated all or any part (as determined by the *FSCS*) of its rights and claims against the *relevant person* (or where relevant, a *successor*) under the *protected contract of insurance* or against any third party to the *FSCS*, on such conditions (under 13) as the *FSCS* thinks fit; and
- (4) it:
- (a) is not reasonably practicable or appropriate to make, or continue to make, arrangements to secure continuity of insurance under 4.1; and/or
  - (b) would not be appropriate to take, or continue to take, measures under 5.1 to safeguard policyholders of a *relevant person* in financial difficulties.
- 3.2 The *FSCS* may treat *persons* who are or may be entitled to claim compensation as if they had done so.
- 3.3 The *FSCS* may pay compensation (and any recovery or other amount payable by the *FSCS* to the claimant) to a *person* who makes a *claim* on behalf of another *person* if the *FSCS* is satisfied that the *person* on whose behalf the *claim* is made:
- (1) is or would have been an *eligible claimant*; and
  - (2) would have been paid compensation by the *FSCS* had he been able to make the *claim* himself, or to pursue his application for compensation further.

#### **4 SECURING CONTINUITY OF LONG-TERM INSURANCE COVER**

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- 4.1 Subject to 6.1, the *FSCS* must make arrangements to secure continuity of insurance for an *eligible claimant* under a *protected contract of insurance* which is a *contract of long-term insurance* with a *relevant person*, if:
- (1) the *relevant person* is the subject of any of the proceedings listed in 10.4;
  - (2) it is reasonably practicable to do so;
  - (3) in the opinion of the *FSCS* at the time it proposes to make the arrangements, it would be beneficial to the generality of *eligible claimants* covered by the proposed arrangements, and, in situations where the cost of securing continuity of insurance might exceed the cost of paying compensation under 3.1, any additional cost is likely to be justified by the benefits; and
  - (4) where the *relevant person* is a *member*, the *FSCS* is satisfied that the amounts which the *Society* is able to provide from the *Central Fund* are or are likely to be insufficient to ensure that *claims* against the *member* under a *protected contract of insurance* will be met to the level of protection which would otherwise be available under this Part.
- 4.2 In order to secure continuity of insurance under 4.1 the *FSCS* may take such measures as it considers appropriate to:



- (1) secure or facilitate the transfer of the business of the *relevant person* that is *in default* and which consists of carrying out *contracts of long-term insurance* or any part of that business, to another *firm*; and/or
  - (2) secure the issue of policies by another *firm* to *eligible claimants* in substitution for their existing policies.
- 4.3 (1) If the *FSCS* is seeking to secure continuity of insurance under 4.1, it must secure that:
- (a) 100% of any benefit under a *contract of long-term insurance*:
    - (i) where the benefit is payable in the form of income or other regular payment; or
    - (ii) in respect of which *claims* arise from death or incapacity due to injury, sickness, or infirmity; and
  - (b) in all other cases, 90% of any benefit under a *contract of long-term insurance*;
- which in the case of (a) or (b):
- (c) falls due, or would have fallen due, to be paid to any *eligible claimant*; or
  - (d) had already fallen due to be paid to any *eligible claimant* before the beginning of that period and has not yet been paid;
- is paid to the *eligible claimant* in question as soon as reasonably practicable after the time when the benefit in question fell due, or would have fallen due, under contract.
- (2) Any payment under (1) is made subject to and in accordance with any other terms which apply or would have applied under the contract.
  - (3) A payment made under (1) is required to be made regardless of whether the cost of making the payment is more or less than the cost of paying compensation under 3.1 – 3.3.
  - (4) Where a payment is due under (1), the *FSCS* may:
    - (a) make payments to or on behalf of *eligible claimants* on such terms (including any terms requiring repayment in whole or in part) and on such conditions as it thinks fit (subject to (1)); or
    - (b) secure that payments (subject to (1)) are made to or on behalf of any such *eligible claimants* by the liquidator, administrator or provisional liquidator by giving him an indemnity covering any such payments or any class or description of such payments.
- 4.4 For the purposes of 4.3 and 6.1 – 6.3, "benefit" does not include:
- (1) any bonus provided for under the contract unless it was declared and the *policyholder* was contractually entitled to it before the *relevant person* became the subject of one or more of the proceedings listed in 10.4; or

- (2) any reduction which the *FSCS* has determined, or any benefit which the *FSCS* has decided to disregard under 20.7, to the extent that the *FSCS* has decided so to treat it.

4.5 Unless the *FSCS* has decided to treat the liability of the *relevant person* under the contract as reduced or (as the case may be) disregarded under 20.7, it must not treat as a reason for failing to secure, or for delaying the securing of, payments under 4.3 at the level prescribed in that *rule* the fact that:

- (1) it considers that any benefit referred to in 4.3 is or may be excessive in any respect;
- (2) it has referred the contract in question to an independent actuary under 20.6; or
- (3) it considers that it may at some later date decide to treat the liability of the *relevant person* under a contract as reduced or disregarded under 20.7;

save where the *FSCS* decides to exclude certain benefits to the extent that they arise out of the exercise of any option under the policy and for this purpose the option includes, but is not restricted to, a right to surrender the policy.

4.6 In making arrangements to secure continuity of insurance the *FSCS* must use its reasonable endeavours to seek the most cost-effective arrangements available.

## 5 RELEVANT PERSONS IN FINANCIAL DIFFICULTIES

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- 5.1 (1) Subject to 6.1 and 6.2, the *FSCS* may take such measures as it considers appropriate for the purpose of safeguarding the rights of *eligible claimants* under *protected contracts of insurance* which are:
- (a) *contracts of general insurance* with a *relevant person* in financial difficulties as described in 5.4; or
  - (b) *contracts of long-term insurance* with a *relevant person* in financial difficulties as described in 5.4 but in respect of which the *FSCS* is not securing continuity of insurance within 4.1;

if, in the opinion of the *FSCS* at the time it proposes to make the measures, it would be beneficial to the generality of *eligible claimants* covered by the proposed measures, and, in situations where the cost of taking those measures might exceed the cost of paying compensation under 3.1, any additional cost is likely to be justified by the benefits.

- (2) Measures under (1) may be taken on such terms (including terms reducing or deferring payment of any liabilities or benefits provided under any *protected contract of insurance*) as the *FSCS* considers appropriate.

5.2 The measures contemplated in 5.1 include measures to:

- (1) secure or facilitate the transfer of the *insurance business* of the *relevant person*, or any part of the business, to another *firm*;
- (2) give assistance to the *relevant person* to enable it to continue to effect *contracts of insurance* or *carrying out contracts of insurance*; and
- (3) secure the issue of policies by another *firm* to *eligible claimants* in substitution for their existing policies.

- 5.3 If it thinks appropriate, the *PRA* may, in relation to any *relevant person* which is in financial difficulties:
- (1) give the *FSCS* assistance in determining what measures under 5.1 are practicable or desirable;
  - (2) impose constraints on the measures which may be taken by the *FSCS* under 5.1; and/or
  - (3) require the *FSCS* to provide it with information about any measures which it is proposing to take under 5.1.
- 5.4 A *relevant person* is in financial difficulties for the purpose of 5.1 if:
- (1) a liquidator, administrator, provisional liquidator, administrative receiver or interim manager is appointed to the *relevant person*, or a receiver is appointed by the court to manage the *relevant person's* affairs;
  - (2) there is a finding by a court of competent jurisdiction that the *relevant person* is unable to pay its debts;
  - (3) a resolution is passed for winding up of the *relevant person*, unless a declaration of solvency has been made in accordance with section 89 of the Insolvency Act 1986;
  - (4) the *PRA* determines that the *relevant person* is likely to be unable to satisfy *protected claims* against it;
  - (5) approval is given to any company voluntary arrangement made by the *relevant person*;
  - (6) the *relevant person* makes a composition or arrangement with any one or more of its creditors providing for the reduction of, or deferral of payment of, the liabilities or benefits provided for under any of the *relevant person's* policies;
  - (7) the *relevant person* is dissolved or struck off from the Register of Companies;
  - (8) a receiver is appointed over particular property of the *relevant person*;
  - (9) any of (1) to (8) or anything equivalent occurs in respect of the *relevant person* in a jurisdiction outside England and Wales; or
  - (10) in the case of a *relevant person* which is a *member*, the *FSCS* is satisfied that any of (1) to (9) apply to the *member*, and the amounts which the *Society* is able to provide from the *Central Fund* are or are likely to be insufficient to ensure that *claims* against the *member* under a *protected contract of insurance* will be met to the level or protection which would otherwise be available under this Part.

## **6 LIMITS WHEN SECURING CONTINUITY AND TAKING MEASURES IN RELATION TO RELEVANT PERSONS IN FINANCIAL DIFFICULTIES**

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- 6.1 If the *FSCS* makes arrangements to secure continuity of insurance under 4.1 or takes measures for the purpose of safeguarding the rights of *eligible claimants* under 5.1 in respect of a *contract of long-term insurance*:
- (1) where:

- (a) benefits are payable in the form of income or other regular payment; or
- (b) *claims* arise from death or incapacity due to injury, sickness, or infirmity;

it must ensure that the claimant will receive 100% of any future benefit under his *contract of long-term insurance*; and

- (2) in all other cases, it must ensure that the claimant will receive at least 90% of any benefit under his *contract of long-term insurance*;

and in either case, on terms corresponding in all material respects (so far as it appears to the FSCS to be reasonable in the circumstances), to those which have applied under the *contract of long-term insurance*.

6.2 If the FSCS takes measures for the purpose of safeguarding the rights of *eligible claimants* under 5.1 in respect of a *contract of general insurance*:

- (1) where *claims*:

- (a) are in respect of a *liability subject to compulsory insurance*;
- (b) are in respect of a *liability* subject to *professional indemnity insurance*; or
- (c) arise from death or incapacity of the policyholder due to injury, sickness, or infirmity;

it must ensure that the claimant will receive 100% of any benefit under his *contract of general insurance*; and

- (2) in all other cases, it must ensure that the claimant will receive at least 90% of any benefit under his *contract of general insurance*;

and in either case, on terms corresponding in all material respects (so far as it appears to the FSCS to be reasonable in the circumstances), to those which have applied under the *contract of general insurance*.

6.3 If the FSCS secures less than 100% of any benefit of a claimant under a contract falling under 6.1(2) or 6.2(2), then the FSCS must ensure that any future *premiums* that the claimant is committed to paying under the contract will be reduced by an equivalent amount to reflect the reduced benefit.

6.4 Notwithstanding any provision in this Part to the contrary, the FSCS may:

- (1) pay compensation in accordance with 18;
- (2) secure continuity of a *contract of long-term insurance* in accordance with 4.1;
- (3) make a payment to an *eligible claimant* in accordance with 4.3; or
- (4) take such measures as it considers appropriate in accordance with 5.1;

without fully or at all investigating the eligibility of the claimant and/or the validity and/or amount of the *claim*, if in the opinion of the FSCS:

- (5) the costs of investigating the merits of the *claim* are reasonably likely to be disproportionate to the likely benefit of such investigation; and
- (6) (as a result or otherwise) it is reasonably in the interests of *participant firms* to do so.

- 6.5 For the purposes of 4.1(3) and 5.1(1), when assessing the cost of paying compensation under 3.1 – 3.3, the FSCS may have regard to the likely total cost of paying compensation arising out of the default, not just the compensation amounts likely to be payable to particular *eligible claimants* covered by the proposed arrangements for continuity.

## 7 ELIGIBLE CLAIMANTS

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- 7.1 Unless 7.3 applies, an *eligible claimant* is any *person* who at any material time:
- (1) did not come within 7.2; or
  - (2) did come within 7.2, but satisfied a relevant exception in 8.
- 7.2 The following *persons* are not eligible to claim unless an exception in 8.1 – 8.5 applies:
- (1) *Firms* other than a:
    - (a) *sole trader firm*;
    - (b) *credit union*;
    - (c) trustee of a:
      - (i) *stakeholder pension scheme* (which is not an *occupational pension scheme*); or
      - (ii) *personal pension scheme*;
    - (d) *firm* carrying on the *regulated activity* of operating, or winding up, a:
      - (i) *stakeholder pension scheme* (which is not an *occupational pension scheme*); or
      - (ii) *personal pension scheme*; or
    - (e) *small business*;

in each case, whose *claim* arises out of a *regulated activity* for which they do not have a permission).
  - (2) *Overseas financial services institutions*.
  - (3) *Collective investment schemes*, and anyone who is the operator or trustee of such a scheme.
  - (4) Pension and retirement funds, and anyone who is a trustee of such a fund, other than:
    - (a) a trustee of a *personal pension scheme* or a *stakeholder pension scheme* (which is not an *occupational pension scheme*); or
    - (b) a trustee of a *small self-administered scheme* or an *occupational pension scheme* of an employer which is not a *large company*, *large partnership* or *large mutual association*.
  - (5) Supranational institutions, governments, and central administrative authorities.
  - (6) Provincial, regional, local and municipal authorities.

- (7) *Directors of the relevant person (or where applicable, the successor) in default, unless:*
- (a) both of the following apply:
    - (i) the *relevant person* (or where applicable, the *successor) in default* is a mutual association which is not a *large mutual association*; and
    - (ii) the *directors* do not receive a salary or other remuneration for services performed by them for the *relevant person* (or where applicable, the *successor) in default*; or
  - (b) the *relevant person* (or where applicable, the *successor) in default* is a credit union.
- (8) *Bodies corporate in the same group as the relevant person (or where applicable, the successor) in default unless that body corporate is:*
- (a) a trustee of:
    - (i) a *stakeholder pension scheme* (which is not an *occupational pension scheme*) or a *personal pension scheme* (but in each case if the trustee is a *firm* it will only be an *eligible claimant* if its *claim* arises out of a *regulated activity* for which it does not have a permission);
    - (ii) (if the *claim* is with respect to a *contract of long-term insurance*) a *small self-administered scheme* or an *occupational pension scheme*; or
    - (iii) (if the *claim* is not with respect to a *contract of long-term insurance*) a *small self-administered scheme* or an *occupational pension scheme* of an employer which is not a *large company, large partnership* or *large mutual association*; or
  - (b) carrying on the *regulated activity* of operating or winding up a *stakeholder pension scheme* (which is not an *occupational pension scheme*) or *personal pension scheme*.
- (9) *Persons who, in the opinion of the FSCS, are responsible for, or have contributed to, the relevant person's (or where applicable, the successor's) default.*
- (10) *Bodies corporate, partnerships, mutual associations and unincorporated associations which are not small businesses.*
- (11) *Persons whose claim arises from transactions in connection with which they have been convicted of an offence of money laundering.*
- (12) *Persons whose claim arises under the Third Parties (Rights against Insurers) Act 1930 or the Third Parties (Rights Against Insurers) Act 2010.*
- [Note: It is expected that the Third Parties (Rights against Insurers) Act 2010 will come into force in 2014/15]**
- (13) *Alternative investment funds, and anyone who is the AIFM or depositary of an alternative investment fund.*
- (14) *Any person who is or was a partner in a partnership, regardless of whether or not that person is or may be personally liable for any act or omission of the partnership, in*

respect of a *contract of insurance* entered into by, or for the benefit of, that *partnership*.

- 7.3 A *person* who is a *small business* is an *eligible claimant* in respect of a *relevant general insurance contract* entered into before *commencement* only if the *person* is a *partnership*.

## 8 EXCEPTIONS

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- 8.1 A *person* other than one which comes within any of paragraphs (7), (8), (9) or (11) of 7.2 is eligible to claim compensation in respect of a *contract of long-term insurance*.
- 8.2 (1) A *person* falling within paragraphs (1) – (4) of 7.2 is eligible to claim compensation in respect of a *relevant general insurance contract* if, at the date the contract commenced, he was a *small business*.
- (2) Where the contract has been renewed, the last renewal date shall be taken as the commencement date.
- 8.3 A *person* who comes within 7.2(12) is eligible to claim compensation if:
- (1) the *person* insured would have been an *eligible claimant* at the time that his rights against the insurer were transferred to and vested in the *person* who comes within 7.2(12);
- (2) the liability of the *person* insured in respect of the *person* who comes within 7.2(12) was a liability under a contract of employer's liability insurance which would have been a *liability subject to compulsory insurance* had the contract been entered into after 1 January 1972 or (for contracts in Northern Ireland) 29 December 1975; or
- (3) the extent of the liability of the *person* insured in respect of the *person* who comes within 7.2(12) had been agreed in writing by the insurer, or determined by a court or arbitrator, before the date on which the insurer is determined to be *in default*.
- 8.4 A *person* who comes within 7.2 is eligible to claim compensation in respect of a *liability subject to compulsory insurance* if the *claim* is a *claim* under a *protected contract of insurance*.
- 8.5 The FSCS may treat a *person* who comes within paragraph (7) or (9) of 7.2 as eligible to claim compensation where:
- (1) this is desirable to achieve the efficient performance of any of its functions, including without limitation, to facilitate a transfer of business or any part thereof, to secure the issue of policies by another *firm* to *eligible claimants* in substitution for their existing policies, to achieve the efficient payment of compensation, to secure under 4.3 the payment of benefits under a *contract of long-term insurance*; and
- (2) treating these *persons* as eligible to claim compensation would, in the opinion of the FSCS, be beneficial to the generality of *eligible claimants* who will be affected by the action in (1).
- 8.6 8.7 – 8.12 apply to the FSCS in respect of any claim for a contribution by a *responsible person* made on or after 25 July 2006 in relation to a *mesothelioma victim's* claim which is determined by agreement in writing, a court or an arbitrator on or after 3 May 2006.
- 8.7 In 8.8 – 8.12, references to an *insurer* include an *authorised insurance company*, and references to *in default* include an *article 9 default*.



- 8.8 The *rules* in this Part shall have effect as modified to the extent necessary to enable the FSCS to receive, assess, determine and make payments in respect of applications for compensation from *responsible persons* in accordance with article 9A of the *compensation transitional order* and regulation 3 of the *mesothelioma regulations*.
- 8.9 The following specific provisions apply in relation to *claims* of the type referred to in 8.6:
- (1) a *responsible person* is eligible to claim in accordance with the provisions of this chapter;
  - (2) subject to (3), the FSCS may pay compensation to a *responsible person* where it is satisfied that an *eligible claimant* has a claim under a *protected contract of insurance* issued by an *insurer* that is *in default*, which, but for satisfaction of that claim by the *responsible person*, the FSCS would have paid;
  - (3) the FSCS may only pay compensation to a *responsible person* in accordance with (2) if, having satisfied a claim in relation to a *mesothelioma victim*, he could claim contribution from an *insurer* that is *in default*; and
  - (4) the FSCS may pay compensation in respect of any contribution for which an *insurer in default* is liable by agreement in writing, or by a determination of a court or arbitrator.
- 8.10 The requirement in 19.5 to take into account payments to the claimant does not require the FSCS, in paying compensation in respect of such a *claim*, to take into account payments referred to in that *rule* made by a *responsible person* in calculating the claimant's overall *claim*.
- 8.11 8.6 – 8.10 also apply to the extent that any liabilities of an *authorised insurance company* have been assumed by a *successor*.
- 8.12 The FSCS must not pay, in respect of a claim in accordance with the provisions of 8.6 – 8.11, more than the amount that it would have paid if the *mesothelioma victim* (or a *responsible person* other than an *insurer* of such a *person*) to whom the contribution claim relates had made that claim directly against the FSCS.

## 9 PROTECTED CLAIMS

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- 9.1 A *protected claim* is a *claim* under a *protected contract of insurance*.
- 9.2 A *protected contract of insurance* is:
- (1) (if issued after *commencement*) a *contract of insurance* within 9.3; or
  - (2) (if issued before *commencement*) a *contract of insurance* within 9.6.
- 9.3 A *contract of insurance* issued after *commencement* which:
- (1) relates to a protected risk or commitment as described in 9.4;
  - (2) was issued by a *relevant person* (whether or not there is now a *successor* in respect of that *relevant person*) through an establishment in:
    - (a) the *United Kingdom*; or
    - (b) another *EEA State*; or
    - (c) the Channel Islands or the Isle of Man;

- (3) is a *contract of long-term insurance* or a *relevant general insurance contract*;
- (4) is not a *reinsurance contract*; and
- (5) if it is a *contract of insurance* entered into by a *member*, was entered into on or after 1 January 2004;

is a *protected contract of insurance*.

9.4 A risk or commitment is a protected risk or commitment for the purpose of 9.3 if:

- (1) in the case of a *contract of insurance* falling within 9.3(2)(a), it is situated in an *EEA State*, the Channel Islands or the Isle of Man;
- (2) in the case of a *contract of insurance* where the *relevant person* is a *UK firm* issuing a *contract of insurance* through an establishment falling within 9.3(2)(b), it is situated in an *EEA State*;
- (3) in the case of a *contract of insurance* where the *relevant person* is a *firm* which is not a *UK firm* issuing a *contract of insurance* through an establishment falling within 9.3(2)(b), it is situated in the *United Kingdom*; or
- (4) in the case of a *contract of insurance* falling within 9.3(2)(c), it is situated in the *United Kingdom*, the Channel Islands or the Isle of Man.

9.5 For the purpose of 9.4 and 9.6, the situation of a risk or commitment is determined as follows:

- (1) for a *contract of insurance* relating to a building or a building and its contents (in so far as the contents are covered by the same *contract of insurance*), the risk or commitment is situated where the building is situated;
- (2) for a *contract of insurance* relating to vehicles of any type, the risk or commitment is situated where the vehicle is registered;
- (3) for a *contract of insurance* lasting four months or less covering travel or holiday risks (whatever the class concerned), the risk or commitment is situated where the policyholder took out the *contract of insurance*; and
- (4) in cases not covered by (1) – (3):
  - (a) where the policyholder who first took out the *contract of insurance* is an individual, the risk or commitment is situated where he has his *habitual residence* at the date when the *contract of insurance* commenced;
  - (b) where the policyholder who first took out the *contract of insurance* is not an individual, the risk or commitment is situated where the establishment to which the risk or commitment relates is situated at the date when the *contract of insurance* commenced;
  - (c) where the policyholder who first took out the *contract of insurance* is a trustee the risk or commitment is situated:
    - (i) if the trustee is an individual, where the trustee has his *habitual residence* at the date when the *contract of insurance* commenced;

- (ii) if the trustee is not an individual, where the establishment to which the risk or commitment relates is situated at the date when the *contract of insurance* commenced; and
    - (d) where there are two or more policyholders, so long as one policyholder's risk or commitment under (a) – (c) is a protected risk or commitment, that shall be where the risk or commitment is situated.
- 9.6 (1) If after *commencement*, a *relevant person* (or where applicable, a *successor*) is subject to one or more of the proceedings listed in 10.4 (or 11.4, in the case of a *successor*) or where a *relevant person* (or where applicable, a *successor*) is declared *in default*, then a *contract of insurance* issued by that *relevant person* (or where applicable, a *successor*) before *commencement* which is within (2) is a *protected contract of insurance*, provided that the *relevant person* (or where applicable, a *successor*) was not a *member* at the time the *contract of insurance* was issued, and:
- (a) (unless it comes within (b)) at the earlier of the events in (1) it was a "United Kingdom policy" for the purposes of the Policyholders Protection Act 1975; or
  - (b) if the *contract of insurance* is a contract of employers' liability insurance entered into before 1 January 1972 or (for contracts in Northern Ireland) 29 December 1975, and the *claim* was agreed after the default of the *insurer*, the risk or commitment was situated in the *United Kingdom* (as set out in 9.5).
- (2) The *contracts of insurance* referred to in (1) are:
- (a) a *relevant general insurance contract*;
  - (b) a *contract of insurance* within the *credit* class; and
  - (c) a *contract of long-term insurance*;
- which in each case is not a *reinsurance contract*.
- 9.7 If it appears to the *FSCS* that a *person* is insured under a contract which is not evidenced by a policy, and it is satisfied that if a policy evidencing the contract had been issued, the *person* in question would have had a *protected contract of insurance*, the *FSCS* must treat the contract as a *protected contract of insurance*.
- 9.8 The *FSCS* must treat liabilities of a *relevant person* (or where applicable, a *successor*) which is *in default*, in respect of the following items, as giving rise to *claims* under a *protected contract of insurance*:
- (1) (if the contract is not a *reinsurance contract* and has not commenced) *premiums* paid to a *relevant person*;
  - (2) proceeds of a *contract of long-term insurance* that is not a *reinsurance contract* and that has matured or been surrendered which have not yet been passed to the claimant;
  - (3) the unexpired portion of any *premium* in relation to *relevant general insurance contracts* which are not *reinsurance contracts*; or
  - (4) *claims* by *persons* entitled to the benefit of a judgement under section 151 of the Road Traffic Act 1988 or Article 98 of the Road Traffic (Northern Ireland) Order 1981.

## 10 RELEVANT PERSONS IN DEFAULT

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- 10.1 A *relevant person* is a *person* who was, at the time the act or omission giving rise to the *claim* against it took place, a *participant firm*.
- 10.2 A *relevant person* is *in default* if the *FSCS* has determined it to be *in default* under 10.3 and/or 10.4.
- 10.3 Subject to 10.6, and provided that the *FSCS* is not taking measures for the purpose of safeguarding the rights of *eligible claimants* in accordance with 5, the *FSCS* may determine a *relevant person* to be *in default* when it is, in the opinion of the *FSCS* or the *PRA*:
- (1) unable to satisfy *protected claims* against it; or
  - (2) likely to be unable to satisfy *protected claims* against it.
- 10.4 The *FSCS* may determine a *relevant person* to be *in default* if it is satisfied that a *protected claim* exists, and the *relevant person* is the subject of one or more of the following proceedings in the *United Kingdom* (or of equivalent or similar proceedings in another jurisdiction):
- (1) the passing of a resolution for a creditors' voluntary winding up;
  - (2) a determination by the *relevant person's Home State regulator* or other competent authority that the *relevant person* appears unable to meet *claims* against it and has no early prospect of being able to do so;
  - (3) the appointment of a liquidator or administrator, or provisional liquidator or interim manager;
  - (4) the making of an order by a court of competent jurisdiction for the winding up of a company, the dissolution of a partnership, the administration of a company or partnership, or the bankruptcy of an individual; or
  - (5) the approval of a company voluntary arrangement, a partnership voluntary arrangement, or of an individual voluntary arrangement.
- 10.5 For *claims* arising in connection with a *relevant person in default* in accordance with this chapter, the *FSCS* must treat any term in the *relevant person's* constitution or in its *contracts of insurance*, limiting its liabilities under a *contract of long-term insurance* to the amount of its assets, as limiting its liabilities to any claimant to an amount which is not less than the gross assets of the undertaking.
- 10.6 The *FSCS* may not declare a *member* to be *in default* unless it is satisfied that the amounts which the *Society* may provide from the *Central Fund* are or are likely to be insufficient to ensure that *claims* against the *member* under a *protected contract of insurance* will be met to the level of protection which would otherwise be available under this Part.

## 11 SUCCESSORS IN DEFAULT

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- 11.1 A *successor* is a *person* who has assumed responsibility for liabilities arising from acts or omissions of a *relevant person*.
- 11.2 Subject to 11.6, a *successor* is *in default* if the *FSCS* has determined it to be *in default* under 11.3 and/or 11.4.

- 11.3 The FSCS may determine a *successor* to be *in default* when it is, in the opinion of the FSCS, or the PRA:
- (1) unable to satisfy *protected claims* against it; or
  - (2) likely to be unable to satisfy *protected claims* against it.
- 11.4 The FSCS may determine a *successor* to be *in default* if it is satisfied that a *protected claim* exists, and the *successor* is the subject of one or more of the following proceedings in the *United Kingdom* (or of equivalent or similar proceedings in another jurisdiction):
- (1) the passing of a resolution for a creditors' voluntary winding up;
  - (2) where relevant, a determination by the *successor's Home State regulator* or other competent authority that the *successor* appears unable to meet *claims* against it and has no early prospect of being able to do so;
  - (3) the appointment of a liquidator or administrator, or provisional liquidator or interim manager;
  - (4) the making of an order by a court of competent jurisdiction for the winding up of a company, the dissolution of a partnership, the administration of a company or partnership, or the bankruptcy of an individual; or
  - (5) the approval of a company voluntary arrangement, a partnership voluntary arrangement, or of an individual voluntary arrangement.
- 11.5 For *claims* arising in connection with a *successor in default* in accordance with this chapter, the FSCS must treat any term in the *successor's* constitution or in its *contracts of insurance*, limiting its liabilities under a *contract of long-term insurance* to the amount of its assets, as limiting its liabilities to any claimant to an amount which is not less than the gross assets of the undertaking.
- 11.6 The FSCS may not declare a *successor* that is a *member* to be *in default* unless it is satisfied that the amounts which the *Society* may provide from the *Central Fund* are or are likely to be insufficient to ensure that *claims* against the *successor* that is a *member* under a *protected contract of insurance* will be met to the level of protection which would otherwise be available under this Part.

## 12 ASSIGNMENT (AUTOMATIC, ELECTRONIC AND IN WRITING)

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- 12.1 The FSCS must, or if the FSCS is subrogated automatically to the *eligible claimant's* rights may, make any payment of compensation to a claimant in respect of a *protected claim* conditional on the claimant assigning the whole or any part of his rights against the *relevant person* (or where applicable, the *successor*) or against any third party, or both, to the FSCS on such terms as the FSCS thinks fit.
- 12.2 Upon payment of compensation by the FSCS (including partial compensation) to an *eligible claimant* in respect of a *protected claim*, all of that claimant's rights against the *relevant person* (or where applicable, the *successor*) and any third party involved in or connected to the *claim* will be deemed to be automatically assigned by way of legal assignment to the FSCS absolutely on terms published by the FSCS.
- 12.3 Production of a statement showing such payment was made pursuant to 12.2 shall be conclusive evidence (or in Scotland sufficient evidence) that a legal assignment has been deemed to have been made under.

- 12.4 An assignment completed and signed electronically in a form prescribed by the *FSCS* will be deemed to satisfy the formalities for a valid legal assignment.
- 12.5 Production of a hard copy of the electronically signed assignment form shall be conclusive evidence (or in Scotland sufficient evidence) that the formalities of a legal assignment have been complied with and that a legal assignment has occurred.
- 12.6 An assignment completed electronically in the prescribed form shall be treated as having been made by writing under the hand of the assignor for the purposes of section 136 of the Law of Property Act 1925 and any other formal requirement whatsoever without limitation.
- 12.7 If a claimant assigns the whole or any part of his rights against any *person* to the *FSCS* in accordance with this chapter, the effect of this is that any sum payable in relation to the rights so assigned will be payable to the *FSCS* and not the claimant.
- 12.8 The *FSCS* must inform the claimant that if, after taking assignment of rights, the *FSCS* decides not to pursue recoveries using those rights it will, if the claimant so requests in writing, reassign the assigned rights to the claimant. The *FSCS* must comply with such a request in such circumstances.
- 12.9 (1) The *FSCS* may determine that:
- (a) if the claimant does not assign or transfer his rights under this chapter;
  - (b) if it is impractical to obtain such an assignment or transfer; and/or
  - (c) if it is otherwise necessary or desirable in conjunction with the exercise of the *FSCS*'s powers under this chapter or 13;
- that claimant shall be treated as having irrevocably and unconditionally appointed the chairman of the *FSCS* for the time being to be his attorney and agent and on his behalf and in his name or otherwise to do such things and execute such deeds and documents as may be required under such laws of the *United Kingdom*, another *EEA State* or any other state or country to create or give effect to such assignment or transfer or otherwise give full effect to those powers.
- (2) The execution of any deed or document under (1) shall be as effective as if made in writing by the claimant or by his agent lawfully authorised in writing or by will.

### 13 AUTOMATIC SUBROGATION

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- 13.1 The *FSCS*'s powers in this chapter may be used:
- (1) separately or in any combination as an alternative and in substitution for the powers and processes elsewhere in this Part; and/or
  - (2) in relation to all or any part of a *protected claim* or class of *protected claim* made with respect to the *relevant person* (or where applicable, the *successor*).
- 13.2 The *FSCS* may determine that the exercise of any power in this chapter is subject to such incidental, consequential or supplemental conditions as the *FSCS* considers appropriate.
- 13.3 (1) Any power conferred on the *FSCS* to make determinations under this chapter is exercisable in writing.

- (2) An instrument by which the *FSCS* makes the determination must specify the provision under which it is made, the date and time from which it takes effect and the *relevant person* (or where applicable, the *successor*) and *protected claims*, parts of *protected claims* and/or classes of *protected claims* in respect of which it applies.
  - (3) The *FSCS* must take appropriate steps to publish the determination as soon as possible after it is made. Such publication must be accompanied by a statement explaining the effect of 13.2.
  - (4) Failure to comply with any requirement in this *rule* does not affect the validity of the determination.
  - (5) A determination by the *FSCS* under this chapter may be amended, remade or revoked at any time and subject to the same conditions.
- 13.4 (1) The production of a copy of a determination purporting to be made by the *FSCS* under this chapter:
- (a) on which is endorsed a certificate, signed by a member of the *FSCS*'s staff authorised by it for that purpose; and
  - (b) which contains the required statements;
- is evidence (or in Scotland sufficient evidence) of the facts stated in the certificate.
- (2) The required statements are:
    - (a) that the determination was made by the *FSCS*; and
    - (b) that the copy is a true copy of the determination.
  - (3) A certificate purporting to be signed as mentioned in (1) is to be taken to have been properly signed unless the contrary is shown.
  - (4) A *person* who wishes in any legal proceedings to rely on a determination may require the *FSCS* to endorse a copy of the determination with a certificate of the kind mentioned in (1).
- 13.5 Other provisions in this Part are modified to the extent necessary to give full effect to the powers provided for in this chapter.
- 13.6 Other than as expressly provided for, nothing in this chapter is to be taken as limiting or modifying the rights or obligations of or powers conferred on the *FSCS* elsewhere in this Part.
- 13.7 The *FSCS* may determine that the payment of compensation by the *FSCS* shall have all or any of the following effects:
- (1) the *FSCS* shall immediately and automatically be subrogated, subject to such conditions as the *FSCS* determines are appropriate, to all or any part (as determined by the *FSCS*) of the rights and claims in the *United Kingdom* and elsewhere of the claimant against the *relevant person* (or where applicable, the *successor*) and/or any third party (whether such rights are legal, equitable or of any other nature whatsoever and in whatever capacity the *relevant person* (or where applicable, the *successor*) or third party is acting in respect of or arising out of the *claim* in respect of which the determination under 13.2 was made;

- (2) the *FSCS* may claim and take legal or any other proceedings or steps in the *United Kingdom* or elsewhere to enforce such rights in its own name or in the name of, and on behalf of, the claimant or in both names against the *relevant person* (or where applicable, the *successor*) and/or any third party;
- (3) the subrogated rights and claims conferred on the *FSCS* shall be rights of recovery and claims against the *relevant person* (or where applicable, the *successor*) and/or any third party which are equivalent (including as to amount and priority and whether or not the *relevant person* (or where applicable, the *successor*) is insolvent) to and do not exceed the rights and claims that the claimant would have had; and/or
- (4) such rights and/or obligations (as determined by the *FSCS*) as between the *relevant person* and the claimant arising out of the *protected claim* in respect of which the determination under 13.2 was made may be transferred to, and subsist between, another *firm* with an appropriate *permission* and the claimant provided that the *firm* has consented (but the transferred rights and/or obligations shall be treated as existing between the *relevant person* and the *FSCS* to the extent of any subrogation, transfer or assignment for the purposes of (1) to (3) and 12).

## 14 RECOVERIES

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- 14.1 If the *FSCS* takes assignment or transfer of rights from the claimant or is otherwise subrogated to the rights of the claimant, it must pursue all and only such recoveries as it considers are likely to be both reasonably possible and cost effective to pursue.
- 14.2 If the *FSCS* decides not to pursue such recoveries and a claimant wishes to pursue those recoveries himself and so requests in writing, the *FSCS* must comply with that request and assign the rights back to the claimant.
- 14.3 If the *FSCS* makes recoveries in relation to a *claim* it may deduct from any recoveries paid over to the claimant under 14.4 part or all of its reasonable costs of recovery and distribution (if any).
- 14.4 If a claimant assigns or transfers his rights to the *FSCS* or a claimant's rights and claims are otherwise subrogated to the *FSCS* and the *FSCS* subsequently makes recoveries through those rights or claims, those recoveries must be paid to the claimant:
  - (1) to the extent that the amount recovered exceeds the amount of compensation (excluding interest paid under 18.6) paid to the claimant in relation to the *protected claim* in accordance with 18; or
  - (2) in circumstances where the amount recovered does not exceed the amount of compensation paid, to the extent that failure to pay any sums recovered to the claimant would leave a claimant who had promptly accepted an offer of compensation or whose rights and claims had been subrogated to the *FSCS* at a disadvantage relative to a claimant who had delayed accepting an offer of compensation or whose claims had not been subrogated (in accordance with 14.6).
- 14.5 For the purpose of 14.4, compensation received by *eligible claimants* in relation to *Lloyd's policies* may include payments made from the *Central Fund*.
- 14.6 The *FSCS* must endeavour to ensure that a claimant will not suffer disadvantage arising solely from his prompt acceptance of the *FSCS*'s offer of compensation or from the subrogation of his rights and claims to the *FSCS* compared with what might have been the position had he delayed his acceptance or had his claims not been subrogated.



## 15 REJECTION OF APPLICATION FOR, AND WITHDRAWAL OF OFFER OF COMPENSATION

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- 15.1 If an application for compensation contains any material inaccuracy or omission, the *FSCS* may reject the application unless this is considered by the *FSCS* to be wholly unintentional.
- 15.2 The *FSCS* must reject an application for compensation if:
- (1) the *FSCS* considers that a civil claim in respect of the liability would have been defeated by a defence of limitation at the earlier of:
    - (a) the date on which the *relevant person* (or where applicable, the *successor*) is determined to be *in default*; and
    - (b) the date on which the claimant first indicates in writing that he may have a claim against the *relevant person* (or where applicable, the *successor*); or
  - (2) the liability of the *relevant person* (or where applicable, the *successor*) to the claimant has been extinguished by the operation of law.
- 15.3 The *FSCS* may withdraw any offer of compensation made to a claimant if the offer is not accepted or if it is not disputed within 90 days of the date on which the offer is made.
- 15.4 Where the amount of compensation offered is disputed, the *FSCS* may withdraw the offer but must consider exercising its powers to make a reduced or interim payment under 18.4 or 18.5 before doing so.
- 15.5 The *FSCS* may repeat any offer withdrawn under 15.3 or 15.4.
- 15.6 The *FSCS* must withdraw any offer of compensation if it appears to the *FSCS* that no such offer should have been made.
- 15.7 The *FSCS* must seek to recover any compensation paid to a claimant if it appears to the *FSCS* that no such payment should have been made, unless the *FSCS* believes on reasonable grounds that it would be unreasonable to do so, or that the costs of doing so would exceed any amount that could be recovered.

## 16 TIME LIMITS ON PAYMENT AND POSTPONING PAYMENT

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- 16.1 The *FSCS* must pay a *claim* as soon as reasonably possible after:
- (1) it is satisfied that the conditions in 3.1 have been met; and
  - (2) it has calculated the amount of compensation due to the claimant;
- and in any event within three months of that date, unless the *PRA* has granted the *FSCS* an extension, in which case payment must be made no later than six months from that date.
- 16.2 The *FSCS* may postpone paying compensation if:
- (1) it considers that the liability to which the *claim* relates or any part of the liability is covered by another *contract of insurance* with a solvent *insurance undertaking* (or where applicable, a *member*), or where it appears that a *person*, other than the liquidator, may make payments or take such action to secure the continuity of cover as the *FSCS* would undertake;
  - (2) it is not practicable for payment to be made within the usual time limit laid out in 16.1;

- (3) the claimant has been charged with an offence arising out of or in relation to *money laundering*, and those proceedings have not yet been concluded; or
- (4) the *claim* relates solely to a bonus provided for under a *protected contract of insurance* the value of which the *FSCS* considers to be of such uncertainty that immediate payment of compensation in respect of that bonus would not be prudent and a court has yet to attribute a value to such bonus.

## 17 LIMITS ON COMPENSATION PAYABLE

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17.1 The limits on the maximum compensation sums payable by the *FSCS* for *protected claims* are set out in 17.2.

- 17.2 (1) For a *protected contract of insurance* when the contract is a *relevant general insurance contract*:
- (a) if the *claim*:
    - (i) is in respect of a *liability subject to compulsory insurance*;
    - (ii) is in respect of a liability subject to *professional indemnity insurance*; or
    - (iii) arises from death or incapacity of the policyholder due to injury, sickness, or infirmity;

the level of cover is 100% of the *claim*; and
  - (b) in all other cases the level of cover is 90% of the *claim*; and
- in each case, cover shall be determined in accordance with 19 and 20 and there is no upper limit on the amount that can be paid.
- (2) For a *protected contract of insurance* when the contract is a *contract of long-term insurance*:
- (a) if:
    - (i) benefits falling due are payable in the form of income or other regular payment; or
    - (ii) the *claim* arises from death or incapacity due to injury, sickness, or infirmity;

the level of cover is 100% of the *claim*; and
  - (b) in all other cases the level of cover is 90% of the *claim*; and
  - (c) if parts of the *claim* fall within the limits under (a) and (b), the level of cover shall be 100% for those parts of the *claim* falling under (a) and 90% for those parts of the *claim* falling under (b); and
- in each case, the level of cover shall be determined in accordance with 19 and there is no upper limit on the amount that can be paid.

17.3 In applying the financial limits in 17.2 and in calculating the amount of a *claim* in respect of a *protected contract of insurance* arising from the default of one or more *members*, a

*policyholder* is to be treated as having a single *claim* for the aggregate of all such amounts as may be payable on the *claim* in respect of the *protected contract of insurance*.

## 18 PAYMENT OF COMPENSATION

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- 18.1 If the *FSCS* determines that compensation is payable (or any recovery or other amount is payable by the *FSCS* to the claimant), it must pay it to the claimant, or if the *FSCS* so decides, as directed by the claimant, unless:
- (1) arrangements have or are being made to secure continuity of insurance under 4.1 or the *FSCS* is taking measures it considers appropriate to safeguard *eligible claimants* under 5.1; or
  - (2) 18.2 applies.
- 18.2 Where an *eligible claimant* has a *claim* under a *protected contract of insurance* against a *relevant person* (or where applicable, the *successor*) that is in administration, provisional liquidation, or liquidation, the *FSCS* may:
- (1) make payments to or on behalf of *eligible claimants* on such terms (including any terms requiring repayment in whole or in part) and on such conditions as it thinks fit (subject to 17); or
  - (2) secure that payments (subject to 17) are made to or on behalf of any such *eligible claimants* by the liquidator, administrator or provisional liquidator by giving him an indemnity covering any such payments or any class or description of such payments.
- 18.3 The *FSCS* may pay compensation in any form and by any method (or any combination of them) that it determines is appropriate including, without limitation:
- (1) by paying the compensation (on such terms as the *FSCS* considers appropriate) to an *authorised person* with *permission to accept deposits* which agrees to become liable to the claimant in a like sum;
  - (2) by paying compensation directly into an existing deposit account of (or for the benefit of) the claimant, or as otherwise identified by (or on behalf of) the claimant, with an *authorised person* (but before doing so the *FSCS* must take such steps as it considers appropriate to verify the existence of such an account and to give notice to the claimant of its intention to exercise this power); and/or
  - (3) (where two or more *persons* have a joint beneficial *claim*) by accepting communications from and/or paying compensation to any of those *persons* where this is in accordance with the terms and conditions of the *contract of insurance*.
- 18.4 If the *FSCS* is satisfied that in principle compensation is payable in connection with any *protected claim*, but considers that immediate payment in full would not be prudent because of uncertainty as to the amount of the claimant's overall *claim*, it may decide to pay an appropriate lesser sum in final settlement, or to make payment on account.
- 18.5 The *FSCS* may also decide to make a payment on account or to pay a lesser sum in final settlement if the claimant has any reasonable prospect for recovery in respect of the *claim* from any third party or by applying for compensation to any other *person*.
- 18.6 The *FSCS* may pay interest on the compensation sum in such circumstances as it considers appropriate.

- 18.7 Interest under 18.6 is not to be taken into account when applying the limits on the compensation sum payable in respect of a *claim* under 17.
- 18.8 Where the *FSCS* considers that the conditions in 18.4 are satisfied but, in relation to a class of *claim*, in order to provide fair compensation for the generality of such *claims* it would be appropriate, it may for that class of *claim*:
- (1) receive whether by assignment, subrogation, transfer or operation of law the whole or any part of a claimant's rights against the *relevant person* (or where applicable, the *successor*), or against any third party, or all of them on such terms as the *FSCS* thinks fit; and
  - (2) disregard the value of the rights so received in determining the claimant's overall *claim*;

rather than pay an appropriate lesser sum in final settlement or make a payment on account, for that class of *claims*.

## 19 CALCULATING COMPENSATION – GENERAL

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- 19.1 The amount of compensation payable to the claimant in respect of a *protected claim* is the amount of the overall net *claim* against the *relevant person* (or where applicable, the *successor*) at the *quantification date* and any reference in this Part to overall *claim* shall be construed accordingly.
- 19.2 19.1 is, however, subject to the other provisions of this Part, in particular those *rules* that set limits on the amount of compensation payable for the *protected claim*. The limits are set out in 17.
- 19.3 A claimant's overall *claim* is the sum of the *protected claims* of the same category that he has against a *relevant person* (or where applicable, a *successor*) *in default*, less the amount of any liability which the *relevant person* (or where applicable, the *successor*) may set off against any of those *claims*.
- 19.4 In calculating the claimant's overall *claim*, the *FSCS* may rely, to the extent that it is relevant, on any determination by:
- (1) a court of competent jurisdiction;
  - (2) a trustee in bankruptcy;
  - (3) a liquidator;
  - (4) any other recognised insolvency practitioner;
- and on the certification of any net sum due which is made in default proceedings of any exchange or clearing house.
- 19.5 Save as provided in 8.10, the *FSCS* must take into account any payments to the claimant (including amounts recovered by the *FSCS* on behalf of the claimant) made by the *relevant person* (or where applicable, the *successor*) or the *FSCS* or any other *person*, if that payment is connected with the *relevant person's* (or where applicable, the *successor's*) liability to the claimant in calculating the claimant's overall *claim*.
- 19.6 The *FSCS* must calculate the amount of compensation due to the claimant as soon as reasonably possible after it is satisfied that the conditions in 3.1 have been met.

- 19.7 In calculating the claimant's overall *claim* the *FSCS* must take into account the amounts paid by, or expected to be paid by, the *Society* from the *Central Fund* to meet a *member's* liabilities under the contract which gives rise to the *claim*.
- 19.8 For a *claim* under a *protected contract of insurance* that is a *contract of long-term insurance*, the *FSCS* must determine as the *quantification date* a specific date by reference to which the liability of the *relevant person* (or where applicable, the *successor*) to the *eligible claimant* is to be determined.
- 19.9 For a *claim* under a *protected contract of insurance* that is a *relevant general insurance contract*, the *FSCS* must determine as the *quantification date* a specific date by reference to which the liability of the *relevant person* (or where applicable, the *successor*) to the *eligible claimant* is to be determined.
- 19.10 For a *claim* in respect of the unexpired *premiums* under a *protected contract of insurance* that is a *relevant general insurance contract* (treated in accordance with 9.8(3)), the *quantification date*, being the date by which the liability of the *relevant person* (or where applicable, the *successor*) to the *eligible claimant* is to be determined, is the date the policy was terminated or cancelled.

## 20 THE COMPENSATION CALCULATION

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- 20.1 The *FSCS* must pay a sum equal to 100% of any liability of a *relevant person* (or where applicable, a *successor*) in respect of a *liability subject to compulsory insurance* to the claimant as soon as reasonably practicable after it has determined the *relevant person* (or where applicable, the *successor*) to be *in default*.
- 20.2 The *FSCS* must calculate the liability of a *relevant person* (or where applicable, the *successor*) to the claimant under a *relevant general insurance contract* in accordance with the terms of the contract, and (subject to any limits in 17.2(1)) pay that amount to the claimant.
- 20.3 Unless the *FSCS* is making arrangements to secure continuity of insurance cover under 4.1, the *FSCS* must calculate the liability of a *relevant person* (or where applicable, a *successor*) to the claimant under a *contract of long-term insurance* in accordance with the terms of the contract as it would be valued in a liquidation of the *relevant person* (or where applicable, the *successor*), or (in the absence of such relevant terms) in accordance with such reasonable valuation techniques as the *FSCS* considers appropriate.
- 20.4 (1) Unless the *FSCS* is seeking to secure continuity of cover for a *relevant person* under 4.1 it must:
- (a) pay compensation in accordance with 20.3 for any benefit provided for under a *protected contract of long-term insurance* which has fallen due or would have fallen due under the contract to be paid to any *eligible claimant* and has not already been paid; and
  - (b) do so, as soon as reasonably practicable after the time when the benefit in question fell due or would have fallen due under the contract (but subject to and in accordance with any other terms which apply or would have applied under the contract).
- (2) If the *FSCS* decides to treat the liability of the *relevant person* (or where applicable, the *successor*) under the contract as reduced or (as the case may be) disregarded under 20.7 then, for the purposes of (1), the value of benefits falling due after the date of that decision must be treated as reduced or disregarded to that extent.

(3) Unless it has decided to treat the liability of the *relevant person* (or where applicable, the *successor*) under the contract as reduced or disregarded under 20.7 the *FSCS* must not treat as a reason for failing to pay, or for delaying the payment of compensation in accordance with (1), the fact that:

- (a) it considers that any benefit referred to in (1) is or may be excessive in any respect;
- (b) it has referred the contract in question to an independent actuary under 20.6; or
- (c) it considers that it may at some later date decide to treat the liability of the *relevant person* (or where applicable, the *successor*) under a contract as reduced or (as the case may be) disregarded under 20.7;

save where the *FSCS* decides to exclude certain benefits to the extent that they arise out of the exercise of any option under the policy (for this purpose option includes, but is not restricted to, a right to surrender the policy).

20.5 The *FSCS* must not treat any bonus provided for under a *contract of long-term insurance* as part of the claimant's claim except to the extent that:

- (1) a value has been attributed to it by a court in accordance with the Insurers (Winding Up) Rules 2001 or any equivalent rules or legislative provision in force from time to time; or
- (2) the *FSCS* considers that a court would be likely to attribute a value to the bonus if it were to apply the method set out in those rules.

20.6 (1) If the *FSCS* is:

- (a) seeking to secure continuity of cover under 4.1 or to calculate the liability owed to an *eligible claimant* under 20.3; and
- (b) considers that the benefits provided for under a protected *contract of long-term insurance* are or may be excessive in any respect;

it must refer the contract to an actuary who is independent of the *eligible claimant* and of the *relevant person* (or where applicable, the *successor*).

- (2) In this *rule* and in 20.7, a benefit is only "excessive" if, at the time when the *relevant person* decided to confer or to offer to confer that benefit, no reasonable and prudent *insurer* in the position of the *relevant person* would have so decided given the *premiums* payable and other contractual terms.

20.7 If the *FSCS* is satisfied, following the actuary's written recommendation, that any of the benefits provided for under the contract are or may be excessive, it may treat the liability of the *relevant person* (or where applicable, the *successor*) under the contract as reduced or (as the case may be) disregarded for the purpose of any payment made after the date of that decision.

20.8 The *FSCS* may rely on the value attributed to the contract by the actuary when calculating the compensation payable to the claimant, or when securing continuity of cover.

20.9 When calculating compensation payable to the claimant in accordance with this chapter, the *FSCS* must treat any term in the *relevant person's* (or where applicable, the *successor's*)

constitution or in its *contracts of insurance*, limiting its liabilities under a *contract of long-term insurance* to the amount of its assets, as limiting its liabilities to any claimant to an amount which is not less than the gross assets of the undertaking.

20.10 If a claimant's *claim* includes a *claim* as:

- (1) trustee; or
- (2) the *operator* of, or the *person* carrying on the *regulated activity* of *winding up*, a *stakeholder pension scheme* (which is not an *occupational pension scheme*) or *personal pension scheme*;

the *FSCS* must treat him in respect of that *claim* as if his *claim* was the *claim* of a different *person*.

20.11 If a claimant has a *claim* as a bare trustee or *nominee company* for one or more beneficiaries, the *FSCS* must treat the beneficiary or beneficiaries as having the *claim*, and not the claimant.

20.12 If a claimant has a *claim*:

- (1) as the trustee of a *small self-administered scheme*, or an *occupational pension scheme* of an employer which is not a *large company*, *large partnership* or *large mutual association*, or the trustee or *operator* of, or the *person* carrying on the *regulated activity* of *winding up* a *stakeholder pension scheme* (which is not an *occupational pension scheme*) or *personal pension scheme*; or
- (2) for one or more members of a pension scheme (or, where relevant, the beneficiary of any member) whose benefits are *money-purchase benefits*;

the *FSCS* must treat the member or members (or, where relevant, the beneficiary of any member) as having the *claim*, and not the claimant.

20.13 If any group of *persons* has a *claim* as:

- (1) trustees; or
- (2) *operators* of, or as *persons* carrying on the *regulated activity* of *winding up*, a *stakeholder pension scheme* (which is not an *occupational pension scheme*) or a *personal pension scheme*;

(or any combination thereof), the *FSCS* must treat them as a single and continuing *person* distinct from the *persons* who may from time to time be the trustees, *operators* or *persons* winding up the relevant pension scheme.

20.14 Where the same *person* has a *claim* as:

- (1) trustee for different trusts or for different *stakeholder pension schemes* (which are not *occupational pension schemes*) or *personal pension schemes*; or
- (2) the *operator* of, or the *person* carrying on the *regulated activity* of *winding up*, different *stakeholder pension schemes* (which are not *occupational pension schemes*) or *personal pension schemes*;

this chapter applies as if the *claims* relating to each of these trusts or schemes were claims of different *persons*.

- 20.15 Where the claimant is a trustee, and some of the beneficiaries of the trust are *persons* who would not be *eligible claimants* if they had a claim themselves, the *FSCS* must adjust the amount of the overall *claim* to eliminate the part of the claim which, in the *FSCS*'s view, is a claim for those beneficiaries.
- 20.16 Where any of the provisions of 20.10 – 20.15 apply, the *FSCS* must try to ensure that any amount paid to:
- (1) the trustee; or
  - (2) the *operator* of, or the *person* carrying on the *regulated activity* of winding up, a *stakeholder pension scheme* (which is not an *occupational pension scheme*) or *personal pension scheme*;
- is, in each case:
- (3) for the benefit of members or beneficiaries who would be eligible claimants if they had a claim themselves; and
  - (4) no more than the amount of the loss suffered by those members or beneficiaries.
- 20.17 Where a *person* numbers among his *claims* a *claim* as the personal representative of another, the *FSCS* must treat him in respect of that *claim* as if he were standing in the shoes of that other *person*.
- 20.18 If a claimant has a *claim* under a *contract of general insurance* as agent for one or more *persons*, the *FSCS* must treat each *person* as having the *claim*, not the claimant.
- 20.19 If two or more *persons* have a joint beneficial *claim*, the *claim* is to be treated as a *claim* of the partnership if they are carrying on business together in partnership. Otherwise each of those *persons* is taken to have a *claim* for his share, and in the absence of satisfactory evidence as to their respective shares, the *FSCS* must regard each *person* as entitled to an equal share.
- 20.20 In applying this Part to *claims* arising out of business done with a branch or establishment of the *relevant person* (or where applicable, the *successor*) outside the *United Kingdom*, the *FSCS* must interpret references to:
- (1) persons entitled as personal representatives, trustees, bare trustees or agents, *operators of pension schemes* or *persons* carrying on the *regulated activity* of winding up *pension schemes*; or
  - (2) *persons* having a joint beneficial *claim* or carrying on business in partnership;
- as references to *persons* entitled, under the law of the relevant country or territory, in a capacity appearing to the *FSCS* to correspond as nearly as may be to that capacity.

## 21 FSCS LEVIES

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- 21.1 If a *participant firm* does not pay the total amount of the *participant firm*'s share of the *FSCS* levy, before the end of the date on which it is due, under the relevant provision in this Part, that *participant firm* must pay an additional amount as follows:
- (1) if the share of the *FSCS* levy owing was not paid in full before the end of the due date, an administrative fee of £250; plus



- (2) interest on any unpaid part of the share of the *FSCS* levy owing at the rate of 5% per annum above the Official Bank Rate from time to time in force, accruing on a daily basis from the date on which the amount concerned became due.
- 21.2 If it appears to the *PRA* or the *FSCS* that in the exceptional circumstances of a particular case, the payment of any *FSCS* levy would be inequitable, the *PRA* or the *FSCS* may (unless 21.4 applies) reduce or remit all or part of the levy in question which would otherwise be payable.
- 21.3 If it appears to the *PRA* or the *FSCS* that in the exceptional circumstances of a particular case to which 21.2 does not apply, the retention by the *FSCS* of any *FSCS* levy which has been paid would be inequitable, the *FSCS* may (unless 21.4 applies) refund all or part of that fee or levy.
- 21.4 The *PRA* or the *FSCS* may not consider a claim under 21.2 and/or 21.3 to reduce, remit or refund any overpaid amounts paid by a fee or levy payer in respect of a particular period, due to a mistake of fact or law by the fee or levy payer, if the claim is made by the fee or levy payer more than 2 years after the beginning of the period to which the overpayment relates.
- 21.5 (1) A *participant firm* which does not conduct business that could give rise to a *protected claim* by an *eligible claimant* and has no reasonable likelihood of doing so is exempt from a *specific costs levy*, or a *compensation costs levy*, or both, provided that:
- (a) it has notified the *FSCS* in writing that those conditions apply, and has received written confirmation from *FSCS* that those conditions apply; and
  - (b) the conditions in fact continue to apply.
- (2) The exemption takes effect from the date on which the *participant firm* receives confirmation from the *FSCS* that those conditions apply.
- 21.6 A *participant firm* which is exempt under 21.5 must notify the *FSCS* in writing as soon as reasonably practicable if the conditions in 21.5 no longer apply.
- 21.7 If a *participant firm* ceases to conduct business that could give rise to a *protected claim* by an *eligible claimant* and notifies the *FSCS* of this under 21.5(1)(a), it will be treated as a *participant firm* to which 21.48 applies until the end of the financial year of the *compensation scheme* in which the notice was given.
- 21.8 For the purposes of 21.5, a *participant firm* will only be exempt from a *specific costs levy* or *compensation costs levy* for any given financial year if it met the conditions in 21.5 on 31 March of the immediately preceding financial year.
- 21.9 The *FSCS* may at any time impose a *management expenses levy* or a *compensation costs levy*, provided that the *FSCS* has reasonable grounds for believing that the funds available to it to meet relevant expenses are, or will be, insufficient, taking into account expenditure already incurred, actual and expected recoveries and:
- (1) in the case of a *management expenses levy*, the level of the *FSCS*'s expected expenditure in respect of those expenses in the financial year of the *compensation scheme* in relation to which the levy is imposed;
  - (2) in the case of a *compensation costs levy* relating to *protected claims*:
    - (a) the *FSCS*'s expenditure in respect of *compensation costs* expected in the 12 months following the levy; or, if greater

- (a) one third of the *FSCS's* expenditure in respect of *compensation costs* expected in the 36 *months* following the levy.
- 21.10 In the calculation of levies, the *FSCS* will also take into account previous levies, where funds raised in anticipation of meeting liabilities prove either more or less than the amount actually required.
- 21.11 The maximum aggregate amount of *compensation costs* and *specific costs* for which the *FSCS* can levy each *insurance class* in any one financial year of the *compensation scheme* is limited to the amounts set out in the table in *Annex 1*.
- 21.12 The *FSCS* may include in a *compensation costs levy* the costs of compensation paid by the *FSCS* in error, provided that the payment was not made in bad faith.
- 21.13 The *FSCS* must hold any amount collected from a *specific costs levy* or *compensation costs levy* to the credit of the *insurance classes* in accordance with the allocation established under 21.31 and 21.35.
- 21.14 Any funds received by the *FSCS* by way of levy or otherwise for the purposes of the *policyholder protection scheme* are to be managed as the *FSCS* considers appropriate, and in doing this the *FSCS* must act prudently.
- 21.15 Interest earned by the *FSCS* in the management of funds held to the credit of an *insurance class* must be credited to that *insurance class*, and must be set off against the *management expenses* or *compensation costs* allocated to that *insurance class*.
- 21.16 The *FSCS* must keep accounts which include:
- (1) the funds held to the credit of each *insurance class*; and
  - (2) the liability of that *insurance class*.
- 21.17 (1) The *FSCS* may use any money held to the credit of one *insurance class* (the creditor *insurance class*) to pay *compensation costs* or *specific costs* attributable or allocated by way of levy to the other *insurance class* (the debtor *insurance class*) if the *FSCS* has reasonable grounds to believe that this would be more economical than borrowing funds from a third party or raising a levy.
- (2) Where the *FSCS* acts in accordance with (1), it must ensure that:
- (a) the creditor *insurance class* is reimbursed by the debtor *insurance class* as soon as possible;
  - (b) the debtor *insurance class* pays interest at a rate equivalent to the Bank of England's repo rate from time to time in force; and
  - (c) the amount lent by the creditor *insurance class* to the debtor *insurance class* is taken into account by the *FSCS* when considering whether to impose a *compensation costs levy* on the creditor *insurance class* under 21.9.
- 21.18 Unless 21.19 applies, any recoveries made by the *FSCS* in relation to *protected claims* must be credited to the *insurance classes* to which the related *compensation costs* was attributable.
- 21.19 (1) Where the *FSCS* makes recoveries in relation to *protected claims* where a related *compensation costs levy* would have been allocated to a *insurance class* (class X)

had the *levy limit* for class X not been reached and has been allocated to the other *insurance class*, the recoveries must be applied:

- (a) first, to the *insurance class* to which the costs levied were allocated in the same proportion as that *insurance class* contributed, up to the total amount of that allocation plus interest at a rate equivalent to the Bank of England's Official Bank Rate from time to time in force; and
- (b) thereafter, to class X.

(2) This *rule* applies even though the recovery is made in a subsequent financial year.

21.20 Recoveries under 21.19 are net of the costs of recovery.

21.21 If the *FSCS* has more funds (whether from levies, recoveries or otherwise) to the credit of an *insurance class* than the *FSCS* believes will be required to meet levies on that *insurance class* for the next 12 *months*, it may refund the surplus to members or former members of the *insurance class* on any reasonable basis.

21.22 The *FSCS* may adjust the calculation of a *participant firm's* share of any levy imposed in accordance with this chapter to take proper account of:

- (1) any excess, not already taken into account, between previous levies of that type imposed in relation to previous periods and the relevant costs actually incurred in that period;
- (2) *participant firms* that are exempt from the levy under 21.5 to 21.8;
- (3) amounts that the *FSCS* has not been able to recover from *participant firms* as a result of 21.11;
- (4) amounts that the *FSCS* has not been able to recover from *participant firms* after having taken reasonable steps;
- (5) 21.25, 21.33 or 21.40; or
- (6) anything else that the *FSCS* believes on reasonable grounds should be taken into account.

21.23 The *FSCS* may not adjust the calculation of a *participant firm's* share of any levy imposed under this chapter under 21.22 on the grounds that it would be inequitable for that *firm* to pay that share or part of it or on the grounds that it would be inequitable for the *FSCS* to retain that share or part of it.

21.24 (1) This *rule* applies to the calculation of the levies of a *firm* (A) if:

- (a) A:
  - (i) acquires all or a part of the business of another *firm* (B), whether by merger, acquisition of goodwill or otherwise; or
  - (ii) becomes authorised as a result of B's simple change of legal status (as defined in *FEES 3 Annex IR Part 6* in the PRA Handbook);
- (b) B is no longer liable to pay a levy; and

- (c) that acquisition or change takes place after the date to which, or as of which, A's most recent statement of business under 21.42 is drawn up so far as concerns the *insurance classes* covered by B's business.
  - (2) A must pay an additional amount equal to the levy that would have been payable by B in relation to the relevant business and relevant *insurance class* if the acquisition or change in legal status had not taken place and B had remained liable to pay levies. The amount is based on the most recent information supplied by B under 21.42. A is included in the *insurance classes* applicable to the relevant business.
  - (3) This *rule* only applies with respect to those financial years of the *FSCS* for which A's levies are calculated on the basis of a statement of business under 21.42 drawn up to a date.
- 21.25 If a *participant firm's* share of a levy or an additional administrative fee under 21.42 would be so small that, in the opinion of the *FSCS*, the costs of collection would be disproportionate to the amount payable, the *FSCS* may treat the *participant firm* as if its share of the levy or additional administrative fee amounted to zero.
- 21.26 The *FSCS* may impose a levy on the *Society* to be calculated as the aggregate of the levies that would be imposed on each *member* if this chapter applied to *members*, as follows:
- (1) a proportionate share of a *base costs levy* in respect of the *compensation scheme's* costs for the period from 1 January 2004 to the end of the *compensation scheme's* financial year and a share of such levies for all subsequent financial years; and
  - (2) a *specific costs levy* and a *compensation costs levy* in respect of costs arising out of a *relevant person* being *in default*, arrangements made under 4.1 or measures taken under 5.1 where:
    - (i) the default occurs or the circumstances giving rise to the arrangements being made or the measures being taken, as the case may be, occur; and
    - (ii) the *protected contracts of insurance* in connection with which the costs arise were entered into;
- on or after 1 January 2004.
- 21.27 A *participant firm* must pay to the *FSCS* a share of each *management expenses levy*.
- 21.28 A *participant firm's* share of a *management expenses levy* consists of one or more of: (1) a share of a *base costs levy* and (2) a share of a *specific costs levy*.
- 21.29 The *FSCS* must ensure that each *participant firm's* share of a *management expenses levy* separately identifies the *firm's* share of the *base costs levy* and *specific costs levy*.
- 21.30 Subject to 21.25, the *FSCS* must calculate a *participant firm's* share of a *base costs levy* in accordance with the *FSCS Management Expenses Levy Limit and Base Costs Part*.
- 21.31 The *FSCS* must allocate any *specific costs levy* amongst the relevant *insurance class* in proportion to the amount of relevant costs arising from the different activities for which *firms* in that *insurance class* has *permission* up to the *levy limit* of the relevant *insurance class*.
- 21.32 The *FSCS* must calculate a *participant firm's* share of a *specific costs levy* (subject to 21.24) by:

- (1) identifying each relevant *insurance class* to which the *participant firm* belongs, using the statement of business most recently supplied under 21.42;
- (2) identifying the *management expenses* other than *base costs* which the *FSCS* has incurred, or expects to incur, in the relevant financial year of the *compensation scheme*, allocated to the *insurance classes* identified in (1), but not yet levied;
- (3) calculating, in relation to each relevant *insurance class*, the *participant firm's* tariff base (see *Annex 2*) as a proportion of the total tariff base of all *participant firms* in the *insurance class*, using the statement of business most recently supplied under 21.42;
- (4) applying the proportion calculated in (3) to the figure in (2); and
- (5) if more than one *insurance class* is relevant, adding together the figure in (4) for each *insurance class*.

21.33 A *firm* which becomes a *participant firm* part way through a financial year of the *compensation scheme* will not be liable to pay a share of a *specific costs levy* made in that year.

21.34 (1) This *rule* deals with the calculation of:

- (a) a *participant firm's specific costs levy* in the financial year of the *FSCS* following the *FSCS* financial year in which it became a *participant firm*; or
- (b) a *participant firm's specific costs levy* in the financial year of the *FSCS* in which it had its *permission* extended, and the following *FSCS* financial year; and
- (c) the tariff base for the *insurance classes* that relate to the relevant *permissions* or extensions, as the case may be.

(2) Unless this *rule* says otherwise the tariff base is calculated, where necessary, using the projected valuation of the business to which the tariff relates.

(3) The rest of this *rule* only applies to a *firm* that becomes a *participant firm*, or extends its *permission*, on or after 1 April 2009:

- (a) If a *participant firm's* tariff base is calculated using data from a period that begins on or after it became a *participant firm* or on or after the date that the *participant firm* receives its extension of *permission*, as the case may be, the *participant firm* must use that data.
- (b) If a *participant firm* satisfies the following conditions it must calculate its tariff base under (c) for the *FSCS* financial year following the *FSCS* financial year it became a *participant firm*:
  - (i) it became a *participant firm* or receives its extension of *permission*, as the case may be, between 1 April and 31 December inclusive; and
  - (ii) its tariff base, but for this *rule*, is calculated by reference to the financial year ended in the calendar year ending 31 December or the twelve *months* ending 31 December before the *FSCS* financial year.
- (c) If a *participant firm* satisfies the conditions in (b) it must calculate its tariff base as follows:

- (i) it must use actual data in relation to the business to which the tariff rather than projected valuations;
  - (ii) the tariff is calculated by reference to the period beginning on the date it became a *participant firm* or had its *permission* extended, and ending on the 31 December before the start of the *FSCS* financial year; and
  - (iii) the figures are annualised by increasing them by the same proportion as the period of 12 *months* bears to the period starting from when the *participant firm* became a *participant firm* or had its *permission* extended to the 31 December, as the case may be.
- (d) Where a *participant firm* is required to use a method in (c) it must notify the *FSCS* of its intention to do so by the date specified in 21.42.
- (e) Where a *participant firm* is required to use actual data under this *rule*, *Annex 2* is disapplied, to the extent it is incompatible, in relation to the calculation of that *participant firm's* valuation date in its second financial year.
- 21.35 The *FSCS* must allocate any *compensation costs levy* to the relevant *insurance classes* in proportion to the amount of *compensation costs* arising from, or expected to arise from, claims in respect of the different activities for which *firms* in those *insurance classes* have *permission* up to the *levy limit* of each relevant *insurance class*.
- 21.36 If a *participant firm* which is *in default* has carried on a *regulated activity* other than in accordance with a *permission*, the *FSCS* must treat any *compensation costs* or *specific costs* arising out of that activity as if the relevant *permission* were held by the *participant firm*.
- 21.37 A *participant firm* must pay to the *FSCS* a share of each *compensation costs levy* allocated to the *insurance classes* of which it is a member unless the *firm* is exempt under 21.5 to 21.8 or the *FSCS* has chosen to exercise its discretion under 21.25 in respect of that *firm*.
- 21.38 The *FSCS* must calculate each *participant firm's* share of a *compensation costs levy* (subject to 21.22) by:
- (1) identifying each of the *insurance classes* to which each *participant firm* belongs, using the statement of business most recently supplied under 21.42(1);
  - (2) identifying the *compensation costs* falling within 21.35 allocated, in accordance with 21.32, to the *insurance classes* identified in (1);
  - (3) calculating, in relation to each relevant *insurance class*, the *participant firm's* tariff base (see *Annex 2*) as a proportion of the total tariff base of all *participant firms* in the *insurance class*, using the statement of business most recently supplied under 21.42;
  - (4) applying the proportion calculated in (3) to the figure in (2); and
  - (5) if more than one *insurance class* is relevant, adding together the figure in (4) for each *insurance class*.
- 21.29 When calculating a *participant firm's* share of a *compensation costs levy* or *specific costs levy* allocated to each *insurance class* the *FSCS* must use the *insurance classes* and tariff bases as set out in the table in *Annex 2*.

- 21.40 A *firm* which becomes a *participant firm* part way through a financial year of the *compensation scheme* will not be liable to pay a share of a *compensation costs levy* made in that year.
- 21.41 21.34 applies to the calculation of a *participant firm's compensation costs levy* and its tariff base as it applies to the calculation of its *specific costs levy*.
- 21.42 (1) Unless exempt under 21.5, a *participant firm* must provide the *FSCS* by the end of February each year (or, if it has become a *participant firm* part way through the financial year, by the date requested by the *PRA*) with a statement of:
- (a) the *insurance class* to which it belongs; and
  - (b) the total amount of business (measured in accordance with the appropriate tariff base or tariff bases) which it conducted, in respect of the most recent valuation period (as specified by *Annex 2*) ending before the relevant year in relation to each *insurance class*.
- (2) In this *rule* the relevant year means the year in which the *month* of February referred to in (1) falls.
- 21.43 If the information in 21.42 has been provided to the *PRA* under other *rule* obligations, a *participant firm* will be deemed to have complied with 21.42.
- 21.44 If a *participant firm* does not submit a complete statement by the date on which it is due in accordance with 21.42 and any prescribed submission procedures:
- (1) the *firm* must pay an administrative fee of £250 (but not if it is already subject to an administrative fee for non-submission of data in the same financial year required under this Part, any other *rule*, the *PRA Handbook* or the *FCA Handbook*); and
  - (2) the *compensation costs levy* and any *specific costs levy* will be calculated using (where relevant) the valuation or valuations of business applicable to the previous period, multiplied by the factor of 1.10 (or, if it has become a *participant firm* part way through a financial year, on the basis of the information provided to the *PRA* for the purposes of *FEES 4.4.2R* in the *PRA Handbook*) or on any other reasonable basis, making such adjustments as seem appropriate in subsequent levies once the true figures are known.
- 21.45 A *participant firm* must pay its share of any levy made by the *FSCS* in one payment.
- 21.46 A *participant firm's* share of a levy to which 21.45 applies is due on, and payable within 30 days of, the date when the invoice is issued.
- 21.47 A *participant firm* liable to pay its share of the levy under 21.45 must do so using one of the methods set out in *FEES 4.2.4R* in the *PRA Handbook* save that no additional amount or discount is applicable.
- 21.48 If a *firm* ceases to be a *participant firm* or carries out activities within one or more *insurance classes* part way through a financial year of the *compensation scheme*:
- (1) it will remain liable for any unpaid levies which the *FSCS* has already made on the *firm*; and
  - (2) the *FSCS* may make one or more levies upon it (which may be before or after the *firm* has ceased to be a *participant firm* or carry out activities within one or more *insurance classes*, but must be before it ceases to be an *authorised person*) for the costs which

it would have been liable to pay had the *FSCS* made a levy on all *participant firms* or *firms* carrying out activities within that *insurance class* in the financial year it ceased to be a *participant firm* or carry out activities within that *insurance class*.



**ANNEX 1: MAXIMUM AGGREGATE AMOUNT OF COMPENSATION COSTS AND SPECIFIC COSTS FOR WHICH THE FSCS CAN LEVY**

<b>INSURANCE CLASS</b>	<b>LEVY LIMIT (£ MILLION)</b>
<b>B1: GENERAL INSURANCE PROVISION</b>	<b>600</b>
<b>C1: LIFE AND PENSIONS PROVISION</b>	<b>690</b>

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## ANNEX 2: METHODOLOGY FOR CALCULATION OF A PARTICIPANT FIRM'S LEVY SHARE

Class B1	General Insurance Provision
Firms with permission for:	(1) effecting contracts of insurance; and/or (2) carrying out contracts of insurance; that are contracts of general insurance.
Tariff base	<p>Class B1: <i>Relevant net premium income</i> and eligible gross technical liabilities. The levy is split into two in the ratio 75:25. The tariff base for the first portion (75%) is calculated by reference to <i>relevant net premium income</i>. The tariff base for the second portion (25%) is based on eligible gross technical liabilities.</p> <p>Eligible gross technical liabilities are calculated in accordance with the method for calculating gross technical liabilities in fee block A3 in Part 3 of FEES 4 Annex 1B R with the following adjustments.</p> <p>(1) Eligible gross technical liabilities are calculated by reference to <i>protected contracts of insurance with eligible claimants</i>.</p> <p>(2) A <i>firm</i> may choose not to apply paragraph (1) and instead include all gross technical liabilities that it would be obliged to take into account for fee block A3 as long as the amount that it would include under (1) is lower.</p> <p>(3) If an <i>incoming EEA firm</i> does not report gross technical liabilities in the way contemplated by this table, the <i>firm's</i> gross technical liabilities are calculated in the same way as they would be for a <i>UK firm</i>.</p> <p>(4) None of the notes for the calculation of fees in fee block A3 in <i>Part 3 of FEES 4 Annex 1B R</i> of the PRA Handbook apply except for the purposes of (2).</p> <p>(5) A <i>directive friendly society</i> must also calculate eligible gross technical liabilities in accordance with this table.</p> <p>(6) A <i>non-directive friendly society</i> must calculate gross technical liabilities as the amount that it is required to show in FSC 2 or FSC 1 - Form 9 line 11 in Appendix 10 of <i>IPRU(FSOC)</i> of the PRA Handbook (assets allocated towards the general insurance business required minimum margin) in relation to the most recent financial year of the <i>firm</i> (as at the applicable reporting date under 21.44) for which the <i>firm</i> is required to have reported that information to the PRA under <i>IPRU(FSOC)</i> of the PRA Handbook. A <i>non-directive friendly society</i> must disregard for this purpose such amounts as are not required to be included by reason of a <i>waiver</i> or a written concession carried forward as an amendment to the <i>rule</i> to which it relates under <i>SUP TP</i> of the PRA Handbook.</p>

Class C1	Life and Pensions Provision
Firms with permission for:	(1) effecting contracts of insurance; and/or (2) carrying out contracts of insurance; that are contracts of long-term insurance (including <i>pure protection contracts</i> ).
Tariff base	<p>Class C1: <i>Relevant net premium income</i> and eligible mathematical reserves. The levy is split into two in the ratio 75:25. The tariff base for the first portion (75%) is calculated by reference to <i>relevant net premium income</i>. The tariff base for the second portion (25%) is based on mathematical reserves.</p> <p>Eligible mathematical reserves are calculated in accordance with the method for calculating mathematical reserves in fee block A4 in <i>Part 3 of FEES 4 Annex 1B R</i> of the PRA Handbook with the following adjustments.</p> <p>(1) Eligible mathematical reserves are calculated by reference to <i>protected contracts of insurance with eligible claimants</i>.</p> <p>(2) A <i>firm</i> may choose not to apply paragraph (1) and instead include all</p>

	<p>mathematical reserves that it would be obliged to take into account for fee block A4 as long as the amount that it would include under (1) is lower.</p> <p>(3) If an <i>incoming EEA firm</i> does not report mathematical reserves in the way contemplated by this table, the <i>firm's</i> mathematical reserves are calculated in the same way as they would be for a <i>UK firm</i>.</p> <p>(4) None of the notes for the calculation of fees in fee block A4 in <i>Part 3 of FEES 4 Annex 1B R</i> of the PRA Handbook apply except for the purposes of (3).</p> <p>(5) A <i>directive friendly society</i> must also calculate eligible mathematical reserves in accordance with this table.</p> <p>(6) A <i>non-directive friendly society</i> must calculate mathematical reserves as the amount that it is required to show in FSC 2 or FSC 1 - Form 9 line 23 in Appendix 10 of <i>IPRU(FSOC)</i> of the PRA Handbook (total mathematical reserves after distribution of surplus) in relation to the most recent financial year of the <i>firm</i> (as at the applicable reporting date under 21.44) for which the <i>firm</i> is required to have reported that information to the <i>PRA</i> under <i>IPRU(FSOC)</i> of the PRA Handbook. A <i>non-directive friendly society</i> must disregard for this purpose such amounts as are not required to be included by reason of a <i>waiver</i> or a written concession carried forward as an amendment to the <i>rule</i> to which it relates under <i>SUP TP</i> of the PRA Handbook.</p> <p>(7) The provisions relating to pension fund management business in <i>Part 3 of FEES 4 Annex 1B R</i> of the PRA Handbook do not apply. A <i>firm</i> undertaking such business that does not carry out any other activities within class C1 (ignoring any activities that would have a wholly insignificant effect on the calculation of its tariff base for <i>class C1</i>) must use its Long-term insurance capital requirement instead of gross technical liabilities. The Long-term insurance capital requirement means the amount that it is required to show as its Long-term insurance capital requirement in Form 2 Line 31 (Statement of solvency - Long-term insurance business) in relation to the most recent financial year of the <i>firm</i> (as at the applicable reporting date under 21.44) for which the <i>firm</i> is required to have reported that information to the <i>PRA</i>.</p> <p>(8) The split in the levy between <i>relevant net premium income</i> and eligible mathematical reserves does not apply to a partnership pension society (as defined in chapter 7 of <i>IPRU(FSOC)</i> (Definitions) of the PRA Handbook). Instead the levy is only calculated by reference to <i>relevant net premium income</i>.</p>
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**PRA RULEBOOK SOLVENCY II FIRMS: LLOYD'S INSTRUMENT [YEAR]**

**Powers exercised**

- A. The Prudential Regulation Authority ("PRA") makes this instrument in the exercise of the following powers and related provisions in the Financial Services and Markets Act 2000 ("the Act"):
- (1) section 137G (The PRA's general rules);
  - (2) section 137T (General supplementary powers);
  - (3) section 213(1) (The compensation scheme); and
  - (4) section 316(1) (Direction by a regulator).
- B. The rule-making powers referred to above are specified for the purpose of section 138G(2) (Rule-making instruments) of the Act.

**Pre-conditions to making**

- C. In accordance with section 138J of the Act (Consultation by the PRA) and section 319 of the Act (Consultation), the PRA consulted the Financial Conduct Authority. After consulting, the PRA published a draft of proposed rules and the proposed direction and had regard to representations made.

**PRA Rulebook Solvency II Firms: Lloyd's Instrument [YEAR]**

- D. The PRA makes the amendments to the Lloyd's (Actuaries and Auditors) Part of the PRA Rulebook as set out in the Annex to this instrument.

**Commencement**

- E. This instrument comes into force on **[DATE]**.

**Citation**

- F. This instrument may be cited as the PRA Rulebook Solvency II Firms: Lloyd's Instrument **[YEAR]**.

**By order of the Board of the Prudential Regulation Authority**  
**[DATE]**

## Annex

In this Annex, new text is underlined and deleted text is struck through.

Part

# **LLOYD'S<sup>1</sup>: ~~ACTUARIES AND AUDITORS~~**

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Chapter content

1. APPLICATION AND DEFINITIONS
2. AUDITORS AND ACTUARIES DIRECTION
3. LLOYD'S AND THE FSCS

Links

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<sup>1</sup> The PRA may change the title of this Part before issuing final rules.

## **1 APPLICATION AND DEFINITIONS**

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- 1.1 This Part applies to the *Society*.
- 1.2 In this Part the following definitions apply:

...

*core provision*

means (as defined in section 316(3) of the *FSMA* (Direction by a regulator)) a provision of *FSMA* mentioned in section 317 of *FSMA* (The core provisions) which applies to the carrying on of an insurance market activity by a *member*, or the *members* of the *Society* taken together, if the *PRA* so directs.

*individual member*

includes a *member* which is a *limited liability partnership* or a *body corporate* whose members consist only of, or of the nominees for, a single natural person or a group of connected persons.

*insurance market activities*

means a *regulated activity* relating to *contracts of insurance* written at Lloyd's.

*former member*

means a *person* who has ceased to be a *member*, whether by resignation or otherwise, in accordance with Lloyd's Act 1982 and any *byelaw* made under it.

*underwriting agent*

means a *firm* permitted by the *Council* to act as an underwriting agent at Lloyd's.

...

## **3 LLOYD'S AND THE FSCS**

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- 3.1 With effect from 15 October 2003, it was directed that the following *core provisions* of *FSMA* apply to the carrying on of *insurance market activities* by *members*:
- (1) Part 9A (Rules and guidance) for the purpose of applying the rules in chapters 1 and 3, the Policyholder Protection Part, the FSCS Management Expenses Levy Limit and Base Costs Part, the Management Expenses in respect of Relevant Schemes Part and relevant interpretative provisions; and
  - (2) Part XV (Financial Services Compensation Scheme).
- 3.2 The *Society* must maintain *byelaws* establishing appropriate and effective arrangements to compensate *individual members* and *former members* who were *individual members* if *underwriting agents* are unable, or likely to be unable, to satisfy claims by those *members* relating to *regulated activities* carried on in connection with their participation in Lloyd's *syndicates*.

## Statement of Policy — The PRA’s expectations on the FSCS (Policyholder Protection)

### Introduction

1. This statement of policy is addressed to the Financial Services Compensation Scheme (FSCS) Limited in respect of its role as scheme manager of the policyholder protection scheme. This statement may also be of interest to insurance firms, the Society of Lloyd’s (Society) and policyholders.
2. The purpose of this statement is to set out the expectations of the Prudential Regulation Authority (PRA), with regard to the FSCS’s general duties. By providing further information clarifying the PRA’s expectations in respect of the administration of the scheme, this statement of policy should help to ensure an effective policyholder protection scheme, advance the safety and soundness of firms, and contribute to securing an appropriate degree of protection for those who are policyholders.
3. This statement of policy is intended to be read together with the insurance specific rules set out in the Policyholder Protection Part and the Lloyd’s Part, which are relevant to the FSCS, insurers, successors (where applicable) and the Society of Lloyd’s. The funding section of the Policyholder Protection Part is also intended to be read together with the FSCS Management Expenses Levy Limit and Base Costs Part and the Management Expenses in respect of Relevant Schemes Part, which apply to the FSCS, insurers, and the Society.

### Background

4. The PRA expects the FSCS to exercise the functions that are conferred on the scheme manager by Part XV of the Financial Services and Markets Act 2000 (FSMA) (as amended by the Financial Services (Banking Reform) Act 2013).
5. The PRA is required, under section 213 of FSMA, to make rules establishing a compensation scheme (the compensation scheme). The PRA expects that the FSCS will only pay claims if a firm is unable or likely to be unable to meet claims against it because of its financial circumstances. If a firm is still trading and has sufficient financial resources to satisfy a claim, the firm will be expected to meet the claim itself.
6. FSMA confers certain powers upon the FSCS, such as the power under section 219 of FSMA (Scheme Manager’s powers to require information) to require persons to provide information.
7. In addition to rules made by the PRA, other aspects of the operation of the FSCS are dealt with through the powers of the FSCS under company law (such as the power to borrow, to

take on premises etc) and through rules made by the Financial Conduct Authority (FCA).

### Applications of rules to Lloyd’s

8. The Society is the society incorporated by Lloyd’s Act 1871 by the name of Lloyd’s.
9. With effect from 15 October 2003, the PRA’s predecessor exercised its power under section 316 of FSMA (Direction by a regulator) to direct in Rule 3.1 of the Lloyd’s Part that certain core provisions in FSMA should apply to members of the Society (an insurance market direction). The effect of the direction is that the PRA may, in relation to members, and in respect of insurance market activities carried on by them, exercise any of the statutory powers conferred by the provisions which are applied by the direction. Those include the powers in Part 9A to make general rules and give guidance and also the powers in Part XV to make rules for the establishment and operation of a compensation scheme. The PRA expects the FSCS to apply the rules in the Policyholder Protection Part which makes provision for the payment of compensation by the FSCS in certain cases arising from insurance business carried on by members and apply the rules in Chapter 21, the FSCS Management Expenses Levy Limit and Base Costs Part and the Management Expenses in respect of Relevant Schemes Part which make provision for raising levies on the Society, if the FSCS levies the Society.
10. The effect of Rules 2.7(4) and 14.5 of the Policyholder Protection Part, (which are subject to Rule 14.4(2)), is to set out the PRA’s expectation on how recoveries are paid in respect of the Society. Any recovery obtained by the FSCS is retained by the FSCS up to an amount equal to the cost to the FSCS of paying compensation. To the extent that the Society is entitled to any part of the recovery (for example, by agreement with the FSCS), it is only paid out of any excess up to a maximum amount equal to that paid out of the Central Fund. Any recovery in excess of the compensation (including payment from the Central Fund) received by the policyholder is paid to the claimant regardless of whether the Society receives the full amount paid from the Central Fund.
11. The insurance market direction in Chapter 3 of the Lloyd’s Part, is intended to set out the PRA’s expectation on the FSCS to protect the interests of policyholders and potential policyholders by:
  - (a) providing for the application of the Policyholder Protection Part in respect of contracts of insurance issued by members (or where applicable, members that are successors); and
  - (b) providing for the application of such other provisions of FSMA as will enable the application of the Policyholder

Protection Part to be effective in relation to insurance market activities carried on by members.

12. Section 317(2) of FSMA (The core provisions) provides that references in an applied core provision to an authorised person are to be read as references to a person in the class to which the insurance market direction applies. With effect from 15 October 2003, references to a relevant person in Part XV of FSMA include a person who was a member at the time the act or omission giving rise to the claim against him took place.

13. The PRA does not expect the Policyholder Protection Part to compensate members or former members (or where applicable, members that are successors) if firms are unable to satisfy claims made in connection with regulated activities relating to their participation in Lloyd's syndicates.

14. In relation to the arrangements referred to in Rule 3.2 of the Lloyd's Part, the PRA expects the FSCS:

- (a) not to compensate losses arising only as a result of underwriting or investment risk to which individual members or former members who were individual members are or were exposed by their participation in Lloyd's syndicates;
- (b) may be restricted to compensation for losses arising out of fraud, dishonesty or failure to account; and
- (c) should cover all regulated activities carried on by underwriting agents relating to Lloyd's syndicate capacity and syndicate membership.

15. The PRA expects the arrangements referred to in Rule 3.2 of the Lloyd's Part to have a governance structure that is operationally independent from the Society but which is nevertheless accountable to the Society for the proper administration of the compensation arrangements.

## Duties of the FSCS

### Administering the compensation scheme

16. The PRA expects the FSCS to:

- (a) pay compensation to eligible claimants, secure continuity of insurance, meet claims for benefits falling due or take such measures it considers appropriate to safeguard the rights of eligible claimants, when a relevant person (or where relevant in respect of a compensation payments only, a successor), is unable or likely to be unable to meet claims against it in accordance with the Policyholder Protection Part; and
- (b) make levies on participant firms, in accordance with Chapter 21 of the Policyholder Protection Part, to enable

it to pay compensation, secure continuity of insurance, or take other such measures it considers appropriate to safeguard the rights of eligible claimants and meet the costs of discharging its functions under the Policyholder Protection Part.

## Paying compensation

17. If the FSCS secures a benefit for a claimant under Rules 4.1 to 4.6 of the Policyholder Protection Part, the FSCS is not required to pay compensation to those claimants.

### Securing continuity of long-term insurance cover

18. The PRA expects the FSCS to seek to secure continuity of cover for long-term insurance contracts if it is reasonably practical to do so and the conditions set out in Rule 4.1 of the Policyholder Protection Part are satisfied. Where FSCS is seeking to secure continuity of cover it will meet claims for benefits falling due. The FSCS may pay compensation only if it is not reasonably practical to secure continuity of cover.

### Relevant person in financial difficulty

19. The PRA expects the FSCS to take measures it considers appropriate for the purposes of safeguarding the rights of eligible claims under protected contracts of insurance where the insurer is in financial difficulties and the conditions in Rule 5.1 of the Policyholder Protection Part are satisfied.

### Claims on behalf of another person

20. Rule 3.3 of the Policyholder Protection Part gives the FSCS the option to pay compensation (and any recovery or other amount payable by the FSCS to a policyholder) to a person on behalf of a policyholder if certain conditions are met. The PRA expects Rule 3.3 of the Policyholder Protection Part may be applied, but not limited to, the following circumstances:

- (a) when a personal representative makes a claim on behalf of the deceased;
- (b) when trustees make a claim on behalf of beneficiaries (for further provisions relating to claims by trustees, see Rules 20.10 to 20.16 of the Policyholder Protection Part);
- (c) when the donee of an enduring power of attorney or a lasting power of attorney makes a claim on behalf of the donor of the power;
- (d) when the Court of Protection makes a claim on behalf of a person incapable by reason of mental disorder of managing and administering his property and affairs; and
- (e) when a policyholder dies before receiving compensation.



### Relevant persons in default

21. The FSCS may determine a relevant person in default under Rule 10.2 of the Policyholder Protection Part. A relevant person is a person who was a participant firm at the time the act or omission giving rise to the claim against it took place. As such, the PRA expects the insurer to be authorised for the purposes of FSMA and the Policyholder Protection Part, at the time the insured event that gave rise to the claim occurred or is notified to the insurer.

### Successors in default

22. The FSCS may determine a successor is in default under Rule 11.3 of the Policyholder Protection Part. A successor is a person who has assumed responsibility for liabilities arising from acts or omissions of a relevant person. All claims that arise against the predecessor relevant person before the assumption of liabilities by a successor (ie reported and unreported claims) fall under the successor rules. All claims that arise, after the assumption of liabilities by a successor (ie reported and unreported claims), will not be covered by the successor rules, but if the successor is a relevant person in its own right, will fall under the relevant person rules.

### Members in default and the Central Fund of the Society

23. The PRA expects that if a member (or where applicable, a member that is a successor) is unable to meet protected claims against it fully, then, in the first instance, any shortfall will be avoided by payments by the Society from the assets of the Central Fund. The FSCS will not consider claims for compensation unless it is satisfied that the amounts which the Society will make available from the Central Fund are, or are likely to be, insufficient to ensure that claims against the member (or where applicable, a member that is a successor) under a protected contract of insurance will be met to the level of protection which would otherwise be available under the Policyholder Protection Part. The amount which the FSCS may pay in respect of any such claim will be limited to the difference between the amount which the claimant will receive, or is expected to receive, from the member and the Society together and the maximum amount of compensation payable in accordance with Chapters 17 and 19 of the Policyholder Protection Part.

### Assignment and subrogation

24. The PRA expects that upon the payment of compensation, the FSCS will determine that such payment has the effect of automatically subrogating the FSCS to the claimant's rights against a relevant person (or where applicable, a successor) and any third party. Further, a payment of compensation has the effect of automatically assigning the FSCS to the claimant's rights against a relevant person (or where applicable, a successor) and any third party. The FSCS will determine the most appropriate method to use in the specific circumstances. It also expects that the FSCS may make (and in

some cases must) make an offer of compensation conditional on the assignment or subrogation of rights to it by a claimant.

### Recoveries

25. The PRA expects under Rule 19.5 of the Policyholder Protection Part, that the FSCS must take into account any payments made to the claimant (including amounts recovered by the FSCS on behalf of the claimant) by the relevant person (or where applicable, the successor), the FSCS or any other person to ensure that the claimant does not suffer any disadvantage arising solely from his prompt acceptance of the FSCS's offer of compensation compared with what might have been the position had he delayed his acceptance.

26. The PRA expects the FSCS to pay recoveries to claimants in cases where the FSCS has been subrogated, or has taken assignment or transfers rights from the claimant and makes a payment of compensation but then makes recoveries from the relevant person (or where applicable, the successor) or any third party that are greater than the amount paid to the claimant. The PRA does not expect the FSCS to pay recoveries where it has not paid compensation.

### Paying claimants

27. The PRA expects that the FSCS will usually pay compensation direct to the policyholder, but in certain circumstances it may be appropriate for the FSCS to pay compensation to someone other than the policyholder. Rule 3.3 and Chapter 18 of the Policyholder Protection Part sets out when those circumstances arise.

### Reduced or interim payments

28. Rule 18.3 of the Policyholder Protection Part applies to compensation payable in connection with any protected claim. The PRA would expect this to apply, for example, to a situation where the FSCS considers it imprudent to make a payment in full because of uncertainty as to the value a court might attribute to a bonus provided for under a long-term insurance contract. In such circumstances the FSCS may make payment of compensation on account to the policyholder in respect of those benefits under the contract of which the value is certain.

29. Factors the PRA expects the FSCS to take into account when considering taking the approach in Rules 18.7(1) and 18.7(2) of the Policyholder Protection Part include:

- (a) whether the amount of claimants' overall claims are likely to be assessed within a reasonable time frame;
- (b) the circumstances of the claimants;
- (c) the circumstances of the claims; and
- (d) the nature of the products to which the claims relate.

## Funding of the FSCS

### Legislation around funding

30. Section 213(3)(b) of FSMA requires the PRA to make rules to enable the FSCS to impose levies on authorised persons (or any class of authorised persons) in order to meet its expenses. These expenses include in particular expenses incurred, or expected to be incurred, in paying compensation, borrowing or insuring risks.

31. Section 224F of FSMA enables the PRA to make rules to enable the FSCS to impose levies on authorised persons (or any class of authorised persons) in order to meet its management expenses incurred if, under Part 15A of FSMA, it is required by HM Treasury to act in relation to relevant schemes. These rules are set out in the Management Expenses in respect of Relevant Schemes Part.

32. Section 223 of FSMA prevents the FSCS from recovering, through a levy, any management expenses attributable to a particular period in excess of the limit set in the Management Expenses Levy Limit and Base Costs Part and FCA rules as applicable to that period.

### Application to the Society

33. Although a member is a participant firm for the purposes of most provisions of the Policyholder Protection Part, the PRA expects a member to be excluded from the definition of participant firm for the purposes of Chapter 21, the Management Expenses Levy Limit and Base Costs Part and the Management Expenses in respect of Relevant Schemes Part. This is because the fees levied in relation to the carrying on of insurance market activities by members will be imposed on the Society rather than individually on each member.

### Levies on Class B1 and Class C1

34. The PRA's rules enable the FSCS to impose levies on participant firms. The PRA has given the FSCS discretion to apply levies on the general insurance provision class (Class B1) and the life and pensions provision class (Class C1). The FSCS may impose three types of levy on the insurance classes, Class B1 and Class C1: a management expenses levy (consisting of a base costs levy and a specific costs levy), a compensation costs levy and a management expenses levy in respect of relevant schemes levy (ie a levy to meet the management expenses incurred by the FSCS under FSMA Part 15A). The FSCS has discretion as to the amount and timing of the levies imposed.

35. The PRA expects that in calculating a compensation costs levy, the FSCS may include up to the greater of one third of the compensation costs expected in the 36 month period following the date of the levy, or the compensation costs expected in the twelve months following that date.

36. In order to allocate a share of the amount of specific costs and compensation costs to be funded by an individual participant firm, the funding arrangements are split between the two PRA insurance classes, Class B1 and Class C1.

37. The Policyholder Protection Part, which requires the FSCS to allocate levies to classes up to its levy limit, meets a requirement of section 213(5) of FSMA that the PRA in making rules to enable the FSCS to impose levies must take account of the desirability of ensuring that the amount of the levies imposed on a particular class of authorised person reflects, so far as practicable, the amount of claims made, or likely to be made, in respect of that class of person.

### Management expenses levy

38. The PRA expects the FSCS to collect a management expenses levy. A management expenses levy may consist of two elements. The first is a base costs levy for the base costs of running the compensation scheme in a financial year, that is, costs which are not dependent upon the level of activity of the compensation scheme and which therefore are not attributable to any specific class. Included in this category are items such as the salary of the members of the board of the FSCS, the costs of the premises which the FSCS occupies, and its audit fees. It would also likely include the cost of any insurance cover secured by FSCS against the risk of it paying claims out in circumstances where the levy limit of the particular class to which the claim would otherwise be attributable has exceeded its levy limit for the year. This is because the insurance cover is likely to benefit each class which may have costs allocated to the other if the levy limit of the other class is breached. The amount that each participant firm pays towards a base costs levy is calculated by reference to the regulatory costs paid by the firm. All participant firms are liable to contribute towards a base costs levy.

39. The second element of a management expenses levy is a specific costs levy for the 'specific costs' of running the compensation scheme in a financial year. These costs are attributable to a class and include the salary costs of certain staff of the FSCS and claims handling and legal and other professional fees. It also may include the cost of any insurance cover that the FSCS secures against the risk of the FSCS paying out claims above a given level in any particular class (but below the levy limit for that class for the year). The specific costs are attributed to the class which is responsible for those costs. When the FSCS imposes a specific costs levy, the levy is allocated to the class which is responsible for those costs up to the relevant levy limits. The FSCS may include in a specific costs levy the specific costs that the FSCS expects to incur (including in respect of defaults not yet declared at the date of the levy) during the financial year of the compensation scheme to which the levy relates. The amount that each participant firm pays towards the specific costs levy is calculated by reference to the amount of business conducted

by the firm in the class to which the FSCS has allocated specific costs. Each class has a separate 'tariff base' for this purpose, set out in Annex 2 of the Policyholder Protection Part. Participant firms may be exempt from contributing to the specific costs levy.

40. The PRA and FCA will consult on the limit on the management expenses attributable to the forthcoming financial year of the FSCS in January each year.

### Compensation costs

41. Insurance compensation costs are attributed to the general insurance provision (Class B1) or the life and pensions provision (Class C1). The PRA expects that, when the FSCS imposes an insurance compensation costs levy, the levy is allocated to Class B1 or Class C1 up to its levy limit.

42. The PRA does not consider that the use made by the FSCS of borrowing facilities to provide liquidity until the next levy should affect the attribution of compensation costs, nor the allocation of compensation cost levies. This is because the allocation of a compensation costs levy occurs at the time that the FSCS imposes a levy.

### Participant firms that are members of more than one class

43. The PRA expects that if a participant firm is a member of more than one class, the total compensation costs levy and specific costs levy for that firm in a particular year will be the aggregate of the individual levies calculated for the firm in respect of each of the insurance classes for that year. Each class has a levy limit which is the maximum amount which may be allocated to that particular class in a financial year for the purposes of the levy.

### Exemption

44. A participant firm to which the conditions in Rule 21.5 of the Policyholder Protection Part no longer apply will then become subject to levies in accordance with Rules 21.7 to 21.9 of the Policyholder Protection Part and any levies imposed under the Management Expenses in respect of Relevant Schemes Part.

45. If a firm fails to notify the FSCS of an exemption under Rule 21.5 of the Policyholder Protection Part by 31 March, the PRA expects that it will be treated as non-exempt for the whole of the next financial year.

46. The PRA expects that the FSCS will usually levy once in each financial year to meet expected expenditure. For compensation costs, the PRA expects the FSCS will levy for the period of twelve months of expected expenditure or, one third of the expected expenditure in the period of 36 months following 1 July in that year, if greater. However, if the compensation costs or specific costs incurred, or expected to

be incurred, exceed the amounts held or reasonably expected to be held to meet those costs, the FSCS may, at any time during the financial year, do one or more of the following:

- (a) impose an interim compensation costs levy or management expenses levy; or
- (b) borrow, including from the National Loans Fund; or
- (c) utilise money collected from firms.

47. The FSCS will generally impose a levy rather than borrow or utilise funds as described in (c), unless the latter options appear to it to be preferable in the specific circumstances prevailing at the relevant time; for example, to address short-term liquidity issues, or in order to deal with a significant failure without having to wait for a levy to be imposed or collected.

### Recovery of fees

48. Paragraphs 31(7) and 35 of Schedule 1ZB of FSMA permit the PRA to recover fees and section 213(6) of FSMA permits the FSCS to recover shares of the FSCS levy payable, as a debt owed to the PRA and FSCS respectively. The PRA and FSCS, as relevant, will consider taking action for recovery (including interest) through the civil courts.

49. The PRA may also take regulatory action in relation to the non-payment of, a share of the FSCS levy, after reference of the matter to the PRA by the FSCS. What action (if any) is taken by the PRA will be decided upon in the light of the particular circumstances of the case.

### Remission of fees and levies

50. The PRA does not expect that a poor estimate or forecast by a fee or levy payer, when providing information relevant to an applicable tariff base, is likely, of itself to, amount to an exceptional circumstance for the purposes of Rules 21.2 or 21.3 of the Policyholder Protection Part. By contrast, a mistake of fact or law by a fee or levy payer may give rise to such a claim.