CHAPTER H16

INSURANCE COMPANIES

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Special legislation: Introduction

H16–01 Insurance, is an area where almost every member of the public has some involvement. As a result, special legislation attempting to prevent insolvency and to deal with its particular problems if insolvency nonetheless occurs has been in force for some years.

This legislation has, until relatively recently, not been greatly altered by the Insolvency Act 1986.[1] A fundamental change, introduced on April 20, 2003, is the giving of priority to insurance creditors over other unsecured creditors (including re-insurance creditors) in the winding-up of an insurer.

This chapter deals with the special legislation for insurance companies, and the features in ordinary insolvency proceedings which are peculiar to both companies and brokers. The Lloyd's market is outside the scope of this chapter.

The Financial Services and Markets Act 2000

H16–02 The Financial Services and Markets Act 2000 (the "FSMA") provides a legal framework for the regulation of the financial services industry in the United Kingdom by the Financial Services Authority (the "FSA"). The FSA took over responsibility for regulating insurance companies on January 1, 1999. The FSMA received the Royal assent on June 14, 2000 and came fully into force on December 1, 2001. In summary, Pt XXIV of the FSMA contains the following provisions relating to insolvency proceedings involving insurance companies:

(1) The absolute prohibition on the voluntary winding-up of insurance companies effecting or carrying out long-term insurance contracts contained under the predecessor legislation has been removed (subject to the FSA giving its prior authority to the winding-up in question).[2]

(2) The FSA is given extensive powers to initiate and become involved in insolvency proceedings relating to insurance companies, including the right to receive the same information as creditors, attend and address (but not, it appears, vote at) meetings of creditors and creditors' committees.[3] A copy of a winding-up petition (presented by a person other than the FSA) against an insurance company must be served on the FSA,[4] as must any application to appoint a provisional liquidator.[5]

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[1] Section 8(4)(a) of the IA 1986, as originally enacted, specifically excluded insurance companies from the class of company in relation to which an administration order may be made. See (H16–12 to H16–13). By comparison even before the passing of the IA 1986 by the UK Parliament, the Republic of Ireland passed, at very short notice, the Insurance (No.2) Act 1983 to introduce the administration concept especially for insurance companies.

[2] FSMA s.366.

[3] FSMA s.365 (voluntary winding-up), ss.367 and 371 (winding-up by the court), s.363 (receivership). There are some limited rights in company voluntary arrangements (CVAs) (s.356).

[4] FSMA s.369(1)

[5] FSMA s.369(2).

(3) In addition to its existing powers to commence winding-up proceedings, the FSA has the power to apply for the appointment of an administrator.[1]

(4) Further provisions confirm the duty of a liquidator of an insurance company to continue the long-term business in liquidation with a view to transferring it as a going concern to another insurance company,[2] the power of the court to reduce the value of insurance contracts (as an alternative to winding-up)[3] and the power of the Treasury to make rules regulating the separate treatment of long term and general assets.[4]

Details of the FSA's policies on how it uses its powers under Part XXIV of the FSMA can be found in Chapter 13 of the FSA's Enforcement Guide in the FSA Handbook of rules and guidance (the "FSA Handbook").

The FSA and Regulatory Reform

H16–03 The government has announced plans to abolish the FSA and move to a new model of regulation by the beginning of 2013. The Financial Services Bill which was published in draft for pre-legislative scrutiny on June 16, 2011, provides, amongst other things, for the establishment of three new regulatory bodies—(a) the Financial Policy Committee which will sit within the Bank of England and be responsible for considering macro issues affecting economic and financial stability and for responding to any threats which it identifies; (b) the Prudential Regulation Authority (the "PRA"), a subsidiary of the Bank of England, which will be responsible for those firms which the government believes should be subject to significant prudential regulation; and (c) the Financial Conduct Authority (the "FCA"), which amongst other things, will be responsible for the conduct of business regulation of all firms. Companies specialising in life insurance, general insurance (including reinsurance), and companies that undertake a combination of those activities will be dual-regulated under the new regime (that is, subject to regulation by both the PRA and the FCA). The PRA will be responsible for the authorisation, prudential regulation and day-to-day supervision of such firms, with the FCA responsible for regulating their conduct. Part of the FCA's role as a conduct of business regulator will be to secure an appropriate degree of protection for consumers in their engagements with insurance firms.

Solvency II

H16–04 It is a time of interesting change in the European insurance regulatory framework.

Solvency II[5] proposes a wide ranging review of solvency and risk management standards across the European insurance and reinsurance industry, by replacing 14 existing EU insurance directives which comprise the "Solvency I" regime with a single one aimed at achieving a high level of regulatory convergence across Europe.

The process remains in some degree uncertain. As matters stand, it is currently expected that January 1, 2013 will be the date when the responsibilities of the European Insurance and Occupational Pensions Authority and supervisors will commence and January 1, 2014 will be when insurance and reinsurance firms will be required to comply with the requirements of Solvency II (although this is subject to the Omnibus II Directive being agreed and adopted).

[1] FSMA s.359.
[2] FSMA s.376(2).
[3] FSMA s.377.
[4] FSMA ss.378, 379.
[5] Directive 2009/138/EC.

The Insurers (Winding-Up) Rules 2001

H16–05 The Insurers (Winding-Up) Rules 2001[1], (the "Winding-Up Rules") made under s.411 of the Insolvency Act 1986 and s.379 of the FSMA, came into force on December 1, 2001 and repealed and replaced the Insurance Companies (Winding-Up) Rules 1985.[2] The Winding-Up Rules set rules for valuing insurance contracts in the event that an insurer is wound up or goes into liquidation. Rule 6 and Sch.1 provide for valuation rules in relation to general business policies. Rules 7 and 8 and Schs 2 to 5 provide for valuation rules in relation to long-term policies. These provisions are discussed below (H16–11 et seq.).

Directive on the Reorganisation and Winding-Up of Insurance Undertakings 2001

H16–06 The EU Directive on the Reorganisation and Winding-Up of Insurance Undertakings[3] ("the Winding-Up Directive") required Member States to introduce national laws implementing its provisions prior to April 20, 2003. The Winding-Up Directive applies to all insurance undertakings which come within the scope of the First Non-Life Co-ordination Directive[4] as amended by the Second Non-Life Directive,[5] and the First Life Co-ordination Directive.[6] The Directive applies to insurers writing direct life and non-life business. In relation to reinsurers, the general rules under the EU Regulation on Insolvency Proceedings apply.[7] The Directive envisages a single set of reorganisation or winding-up proceedings taking place in relation an insurer in the Member State where the insurer has its head office, such proceedings being conducted in accordance with the insolvency law of that state and recognised in all other Member States where the insurer has branches or assets.

The Insurers Reorganisation and Winding-Up Regulations 2004

H16–07 The Winding-Up Directive was implemented in the UK by the Insurers (Reorganisation and Winding-Up) Regulations 2003[8] which came into force on April 20, 2003; and were repealed in their entirety and replaced, on February 18, 2004, by the Insurers (Reorganisation and Winding-Up) Regulations 2004[9] ("the Winding-Up Regulations") which took account of changes to insolvency law made by the Enterprise Act 2002 and, in particular, the new administration regime inserted by the Enterprise Act 2002 as Sch.B1 to the Insolvency Act 1986.

The Regulations are divided into seven parts, as follows:

Part I—General (regs 1–3) Regulation 2 sets out various definitions, including "insurance claim", "insurance creditor" and "insurance debt", but there is no definition of "contract of insurance". A "UK insurer" is defined as "a person who has permission under Pt 4 of the FSMA to effect or carry out contracts of insurance, but

[1] SI 2001/3635.
[2] SI 1985/95.
[3] 2001/17/EC of the European Parliament and of the Council of 19 March 2001. The Directive will be replaced by Directive 2009/138/EC (Solvency II).
[4] 73/239/EEC.
[5] 88/357/EEC.
[6] 79/267/EEC.
[7] See H9–18.1 to H9–18.13.
[8] SI 2003/1102.
[9] SI 2004/353. The new Regulations were introduced to reflect the changes brought about by the commencement of the Enterprise Act 2002. The principal change is to prevent a qualified floating charge holder and/or the company or its directors from putting the company in administration by using the so-called "fast-track" procedures in Sch.B1 to the IA 1986 (paras 14 and 22).

does not include a person who, in accordance with that permission, carries on that activity exclusively in relation to reinsurance contracts". "EEA insurer" is defined to mean "an undertaking, other than a UK insurer, pursuing the activity of direct insurance (within the meaning of art.1 of the first life insurance directive or the first non-life insurance Directive) which has received authorisation under art.6 from its home state regulator." Regulation 3 excludes Lloyd's from the definition of UK insurer.

Part II—Insolvency Measures and Proceedings: Jurisdiction in Relation to Insurers (regs 4–7) Regulation 4 prohibits a court in the UK from making a winding-up order in relation to an EEA insurer, the appointment of a provisional liquidator or the making of an administration order. Regulation 5 provides a specific exclusion in relation to schemes of arrangement (see F1-20). Regulation 6 provides for recognition in the UK of reorganisation measures or winding-up proceedings which have effect under the law of another Member State in relation to an insurer which is authorised in that Member State.

Part III—Modifications of the Law of Insolvency: Notification and Publication (regs 8–16) Regulation 9 provides for notification of the FSA when reorganisation or winding-up proceedings have been commenced. Regulation 10 provides for the FSA to inform EEA regulators, as soon as practicable, of notifications it receives under Regulation 9. Regulation 11 provides for the publication of orders to commence reorganisation or winding-up proceedings in the Official Journal of the European Communities. Regulation 12 provides for notification of creditors of the winding-up or administration of an insurer.

Part IV—Priority of Payment of Insurance Claims in Winding-Up etc. (regs 17–33) Part IV implements art.10 of the Winding-Up Directive which provides for insurance creditors to have priority over other creditors of an insurer in a winding-up. Regulation 18 provides that regs 19 to 27 apply to the winding-up of a UK insurer where the winding-up commences after April 20, 2003.[1]

Part V—Reorganisation or Winding-Up of UK Insurers: Recognition of EEA Rights (regs 34–47) Part V implements arts 19–26 of the Winding-Up Directive and provides for recognition by UK courts (and insolvency practitioners) of rights attaching to certain assets under the law of other EEA Member States.

Part VI—Reorganisation or Winding Up of Third Country Insurers (regs 48–50) Regulation 48 defines "third country insurer" as a person who has permission under the FSMA to effect or carry out contracts of insurance, and whose head office is not in the UK or an EEA state. Regulation 49 provides that in the event of the reorganisation or winding up of a third country insurer, Pts III, IV and V of the Regulations apply.

Part VII—Revocation and Amendments (regs 51–53) Part VII provides for the repeal of the Insurers (Reorganisation and Winding Up) Regulations 2003 and certain amendments to other statutory instruments.

Priority of distribution on winding-up of insurers

H16–08 Regulation 21 of the Insurers (Reorganisation and Winding-Up) Regulations 2004 applies the following order of priority for the payment of debts in the winding-up of a UK insurer (whether it is a long-term insurer, a general insurer or a composite insurer):

> "(2) Subject to paragraph (3), the debts of the insurer must be paid in the following order of priority—

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[1] See H16–08.

(a) preferential debts;
(b) insurance debts;
(c) all other debts.

(3) Preferential debts rank equally among themselves after the expenses of the winding up and must be paid in full, unless the assets are insufficient to meet them, in which case they abate in equal proportions.

(4) Insurance debts rank equally among themselves and must be paid in full, unless the assets available after the payment of preferential debts are insufficient to meet them, in which case they abate in equal proportions.

(5) Subject to paragraph (6), so far as the assets of the insurer available for the payment of unsecured creditors are insufficient to meet the preferential debts, those debts (and only those debts) have priority over the claims of holders of debentures secured by, or holders of, any floating charge created by the insurer, and must be paid accordingly out of any property comprised in or subject to that charge.

(6) The order of priority specified in paragraph (2)(a) and (b) applies for the purposes of any payment made in accordance with paragraph (5).

(7) Section 176A of the 1986 Act and Article 150A of the 1989 Order have effect with regard to an insurer so that insurance debts must be paid out of the prescribed part in priority to all other unsecured debts."

The references in reg.21(7) to the "prescribed part" under s.176A of the Insolvency Act 1986 or art.150A of the Insolvency (Northern Ireland) Order 1989[1] have effect with regard to an insurer so that insurance debts must be paid out of the prescribed part in priority to all other unsecured debts.

For the above purposes, by virtue of reg.2(1), an "insurance creditor" is a person with an insurance claim against a UK insurer and an "insurance claim" is any claim in relation to an insurance debt. An "insurance debt" is a debt to which a UK insurer is, or may become liable, pursuant to a contract of insurance, to a policy holder or to any person who has a direct right of action against that insurer, and includes any premium paid in connection with a contract of insurance (whether or not that contract was concluded) which the insurer is liable to refund.

Regulation and prevention (insurance companies)

H16–09 The FSMA provides that "no person may carry on a regulated activity in the United Kingdom, or purport to do so, unless he is—(a) an authorised person; or (b) an exempt person" (the "General Prohibition").[2] Any person who does so may be guilty of an offence. The Financial Services and Markets Act 2000 (Regulated Activities) Order 2001[3] (the "Order") sets out the activities for which authorisation is required under the FSMA. Article 10 of the Order provides that effecting (i.e. making contracts of insurance as principal) and carrying out (i.e. fulfilling obligations under insurance contracts as principal) is a regulated activity for the purposes of the FSMA, and thus, requires authorisation by the FSA. For these purposes, the term "insurance" includes reinsurance.[4] The regulatory framework rests on the division of all "insurance business" into long-term business and general business, each of which is sub-divided into different categories of contract that are to be treated as

[1] SI 1989/2405 (NI 19).
[2] FSMA s.19(1). An exempt person includes for example the Bank of England, clearing houses and appointed representatives.
[3] (SI 2001/544), as amended.
[4] Article 3 of the Order; FSA Handbook, Perimeter Guidance PERG 5.3.5G.

contracts of insurance for the purposes of regulation under the FSMA. In summary, "long term" comprises contracts of insurance on life, annuity, pension and permanent health insurance, and "general" covers every other type of insurance contract listed in Pt 1 of Sch.1 to the Order.[1] Authorisation may be confined to certain categories of contracts of insurance.

As at September 2011, 1,005 insurers are able to carry out general business in the UK. Of these, 411 are authorised by the FSA and 594 are EEA authorised companies. A further 309 firms are able to carry out long-term business.[2]

There has been much litigation about the effect, under the previous regulatory regime (the Insurance Companies Act 1982), of a company carrying on business without authorisation.[3] The legislation now provides that an insurance contract made by an unauthorised person in contravention of the General Prohibition is unenforceable against the other party (i.e. the insured party) without a court order[4] and voidable at its instance. Thus, the insured party is entitled to recover any money paid by it under the agreement and compensation for any loss sustained as a result of having parted with it.[5] Furthermore, an insurance contract made by an authorised person (insurance provider) in consequence of something said or done by another person (insurance intermediary) in the course of a regulated activity carried on by that person in contravention of the General Prohibition is also unenforceable without a court order and voidable at the instance of the insured party.[6] An example would be of an insurance contract effected by authorised insurance company on the basis of the advice given to the customer by an unauthorised insurance broker (see H16–10).

A foreign reinsurer not authorised (or exempt) in the United Kingdom may be held liable under a contract by the courts of his own country even if the contract would have been held to be illegal under English law as was then understood to be.[7] An agreement to arbitrate is capable of surviving alleged invalidity of which the arbitration agreement formed part so that an arbitrator can have jurisdiction to determine the questions of validity including questions of illegality.[8]

Every insurance company carrying on long-term business is required to appoint an actuary whose name and qualification has to be notified to the FSA.[9] The actuary is required to investigate the financial condition of that business once every year. The assets and liabilities of the long-term business have to be separately identified in the company's accounts and, with specified exceptions, may only be applied for the purposes of that business. Where an insurer is being wound up, the assets representing the fund or funds maintained by the insurer in respect of long-term business are, subject to relevant long-term preferential debts, to be available only for meeting the liabilities of the insurer attributable to that business.[10] In a winding-up the liquidator

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[1] The categories of contract of general insurance prescribed by art.3(1) and Sch. 1 are: 1. accident, 2. sickness, 3. land vehicles, 4. railway rolling stock, 5. aircraft, 6. ships, 7. goods in transit, 8. fire and natural forces, 9. damage to property, 10. motor vehicle liability, 11. aircraft liability, 12. liability of ships, 13. general liability, 14. credit, 15. suretyship, 16. miscellaneous financial loss, 17. legal expenses and 18. assistance. The classes of long-term insurance business are: I. life and annuity, II. marriage and birth, III. linked long term, IV. permanent health, V. tontines, VI. capital redemption contracts, VII, pension fund management, VIII. collective insurance and IX. social insurance.

[2] "UK Insurance – Key Facts", published by the Association of British Insurers in September 2011.

[3] Decisions started with *Phoenix General Insurance Co of Greece SA v Administratia Asigurarilor de Stat* [1988] Q.B. 216; [1987] 2 W.L.R. 512; [1987] 2 All E.R. 152; [1986] 2 Lloyd's Rep. 552.

[4] FSMA s.28.

[5] FSMA s.26.

[6] FSMA s.27.

[7] e.g. *Chorley Company Ltd, Re* [1994] 3 Re. L.R, 187n (Bermuda Supreme Court); *American Special Risk Insurance Co v Delta American Reinsurance Co* (1993) 836 F. Supp. 183 (SDNY).

[8] *Harbour Assurance Co (UK) Ltd v Kansa General International Assurance Co Ltd* [1993] 3 W.L.R. 42; [1993] 1 Lloyd's Rep. 455.

[9] See FSA Handbook, Supervision manual SUP 4.

[10] Insurers (Reorganisation and Winding-Up) Regulations 2004 (SI 2004/353) regs 22 and 23.

must prepare and keep separate financial records in respect of long-term business and other business of the company.[1]

There is no provision for sub-division of the assets representing the fund in respect of long-term business, so as to make them more directly related to the different types of policy which a company may issue. It is quite common for a life company to issue conventional endowment policies at one end of the spectrum and "bonds" linked to the value of, say, equity shares or real property at the other. The value of the latter will fluctuate more than the former (in respect of which bonuses, once declared, are inviolate) and policyholders will thus choose the degree of risk they are willing to undertake.

Nevertheless, the attribution of the underlying assets to a particular type of policy is purely notional so that in the event of the company being wound up all its assets attributed to long-term business fall into one pool in which each policyholder shares according to the value of his policy (calculated in accordance with the Winding-Up Rules).[2] The policyholder who thought that he had adopted a conservative approach may find that he has participated in the speculative choice of the buyer of a property bond. The effect of this is cushioned to some extent by the Financial Services Compensation Scheme which is discussed in H16–14.

Subject to this separation of assets and liabilities of long-term business as above and the priority of insurance debts over other unsecured creditors, all other claims against a UK insurance company rank according to normal insolvency legislation (see Ch.E3) subject to the provisions of Pt III of the Insurers (Reorganisation and Winding-Up) Regulations 2004 (SI 2004/353) (which mainly relates to notification and publication, rather than ranking of claims).[3]

Chapter 2 of the General Prudential Sourcebook: Insurers in the FSA Handbook ("GENPRU 2") contains rules and guidance on the minimum amount of capital that every insurance company is required to hold. This is known as the capital resources requirement (or required margin of solvency). GENPRU 2 sets out provisions that deal with the adequacy of an insurance company's capital resources. An insurance company must maintain at all times capital resources equal to or in excess of its capital resources requirement. If a company fails to hold the required capital resources requirement, the FSA may vary the company's FSA permissions and direct that it cease to be authorised to effect and/or carry out contracts of insurance.[4] The FSA may also require a company to submit a short-term financial scheme and has various powers of intervention.[5] If all else fails the FSA is empowered to petition for a company's winding-up.[6]

Regulation and prevention (brokers)

H16–10 Section 416 and Schedule 22 to the FSMA repealed The Insurance Brokers (Registration) Act 1977 and abolished the Insurance Brokers Registration Council. Since 14 January 2005, insurance brokers carrying on a regulated insurance mediation activity by way of business in the UK have been subject to regulation by the FSA under the FSMA, as discussed in H16–09 above.

Lloyd's brokers remain subject to regulation by Lloyd's.

[1] Insurers (Winding-Up) Rules 2001 (SI 2001/3635) r.5(2).
[2] Insurers (Winding Up) Rules 2001 (SI 2001/3635) Schs 2, 3, 4 and 5.
[3] Insurers (Reorganisation and Winding up) Regulations 2004 (SI 2004/353) reg.8.
[4] FSMA s.45; FSA Handbook, Enforcement Guide, EG 7.3 and EG 8.
[5] FSA Handbook, Supervision manual (SUP) Appendix 2.
[6] FSMA s.367.

Liquidation (insurance companies)

H16–11 Prior to the making of an order by the Treasury pursuant to s.360 of the FSMA extending the administration procedure to insurance companies,[1] the only formal collective procedures available in the United Kingdom to insurance companies apart from liquidation (whether compulsory, provisional or voluntary) were a formal scheme of arrangement[2] or a voluntary arrangement.[3] Voluntary arrangements are normally unlikely to be suitable for insurance companies with large numbers of creditors, possibly spread round the globe.

Schemes of arrangement have proved particularly useful in respect of insurance company insolvencies: see F1–03.

The court may, if it thinks fit, reduce the value of the contracts of an insurance company unable to pay its debts on such terms and conditions as the court thinks just in place of making a winding-up order.[4]

The incidence of insurance companies (certainly life assurance companies) being wound up is comparatively rare. As at May 31, 2011, the last life company to go into liquidation was Oaklife Assurance Co in September 1993.

No insurance company carrying on long-term business may be wound up voluntarily without the consent of the FSA and if notice is given of a general meeting specifying an intention to propose a resolution for voluntary winding-up of a long-term business insurer, the directors of the latter must notify the FSA as soon as they become aware of it.[5] In the case of winding-up proceedings in respect of these companies the liquidator must, unless the court otherwise orders, carry on the long-term business of the company with a view to its being transferred as a going concern to another insurance company.[6] The liquidator may agree to the variation of any contracts of insurance but must not effect any new contracts. In order to assist in such transfer of the business the court may also reduce the value of the contracts made by the company, e.g. reduce the benefits by way of bonuses and surrender values.

In the case of a company carrying on both long-term and general business only the assets attributed to the long-term business would be available to be transferred. To this limited extent the liquidator can be regarded as the equivalent of an administrator, without many of the benefits which the administration procedure allows.

The Winding-Up Rules[7] which apply to proceedings for the winding-up of an insurer which commenced on or after December 1, 2001 are intended to supplement the Insolvency Rules 1986 in relation to the winding-up of insurers in England and Wales. The provisions of the rules can be summarised as follows:

- appointment of liquidator (the Financial Services Compensation Scheme manager may make representations to the court as to the person to be appointed as liquidator in certain circumstances) (r.4);
- liquidator to prepare and maintain separate financial records for long-term and other insurance business in winding-up (r.5);
- valuation rules in relation to a company's general business policies (r.6 and Sch.1);

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[1] Financial Services and Markets Act 2000 (Administration Orders Relating to Insurers) Order 2002 (SI 2002/1242), which came into force on May 31, 2002 and has now been replaced by the Financial Services and Markets Act 2000 (Administration Orders Relating to Insurers) Order 2010, SI 2010/3023. See H16–12 and H16–13.

[2] CA 1985 s.425 (subsequently replaced by the CA 2006 Pt 26).

[3] IA 1986 Pt I.

[4] FSMA s.377.

[5] FSMA s.366.

[6] FSMA s.376.

[7] SI 2001/3635.

- valuation rules in relation to a company's long-term business policies: the Winding-Up Rules introduced new requirements in relation to the valuation of unitised with-profits policies; specified that the interest rate or rates used to calculate the present value of future payments must be fair and reasonable and changed the basis of valuation from a modified net premium basis to a gross premium basis (rr.7, 8 and Sch.2–5);
- provision for the attribution of liabilities and assets to a company's long-term business in cases of doubt (rr.9 and 10);
- liquidator to obtain actuarial advice before taking certain courses of action (r.12);
- prohibition on distribution of excess assets without court direction (r.13);
- Secretary of State may require assets of a company, representing its long-term business, to be held by a trustee (r.15);
- liquidator to comply with requirements by the Secretary of State in relation to, for e.g. refraining from making certain investments and providing information and accounts (rr.17, 18);
- special rules on proof of debts (r.20);
- liquidator may accept late payments of premiums and compensate policyholders whose policies have lapsed (r.21);
- notice of valuation of policy (r.22);
- dividends to and meetings of creditors (rr.23, 24);
- remuneration of liquidators carrying on long-term business (r.25);
- apportionment of costs (r.26);
- notice requirements where stop order made (r.27).

Treasury March 2010 Administration Consultation

H16–12 The low number of insurers being put into administration has meant that procedures and processes surrounding insurers entering into administration have not developed significantly either in practice or in law in recent times (schemes of arrangement have proved a more workable alternative).

In March 2010 the Treasury commenced a consultation exercise entitled Strengthe ning the administration regime for insurers: a consultation ("Consultation Paper").

The Consultation Paper noted that the number of insurers being put into administration or being wound up in the UK has been low. The last case of a life company going into liquidation was Oaklife Assurance Company Limited in 1993. The Consultation Paper noted that gaps remain in the administration regime for insurers in comparison with the liquidation regime and that administration is not particularly well suited to insurance companies which usually have contingent insurance liabilities spread amongst varying creditors who may be located in a number of different countries.

Following the consultation, the Financial Services and Markets Act 2000 (Administration Orders Relating to Insurers) Order 2010 ("the 2010 Order") came into force on 1 Februar y 2011.

The Financial Services and Markets Act 2000 (Administration Orders Relating to Insurers) Order 2010

H16–13 The purpose of an administration order is to achieve one of the following objectives: (i) the rescue of the company as a going concern, (ii) a more advantageous re-

alisation of its assets than would be effected on its winding-up;[1] or the realisation of some or all of the company's property in order to make a distribution to one or more secured or preferential creditors. For a general discussion of administration orders, see Ch.C2.

When the administration system was introduced by the Insolvency Act 1986 with effect from December 29, 1986, it did not apply to insurance companies. This was changed by the Financial Services and Markets Act 2000 (Administration Orders Relating to Insurers) Order 2002[2] ("the 2002 Order"), which came into force on May 31, 2002, and applied the administration regime in relation to insurers[3] under Pt II of the Insolvency Act 1986, subject to the modifications specified in the Schedule to the 2002 Order .

The 2010 Order consolidated the preceding 2002 Order and its amending instruments and made further modifications to Schedule B1 to the Insolvency Act 1986.

Article 2 of the 2010 Order enables administration orders to be made in relation to insurers, applying Part II of the Insolvency Act 1986 to insurers with the modifications set out in the Schedule to the 2010 Order.

The Financial Services Compensation Scheme ("FSCS"), which was established under the FSMA acts as the UK's compensation fund of last resort for customers of authorised financial services firms, including insurers. See H16–14. The 2010 Order requires administrators to provide assistance to the FSCS to enable it to administer the compensation scheme in relation to contracts of insurance and to secure continuity of long term insurance contracts. In relation to long-term insurance, the administrator must also carry on the insurer's business with a view to the business being transferred as a going concern to a person who may lawfully carry out those contracts. There are further changes entitling the FSCS to be represented at the hearing of an administration application in relation to an insurer and entitling it to receive certain creditor notifications.

It should be noted that although the Enterprise Act 2002 amendments to the administration regime allow out-of-court appointments of administrators, these do not apply to insurance companies which may only be put into administration following an administration order from the court.

The first administration order in relation to an insurance company was made on July 19, 2002.[4] An administration order was made in respect of the AA Mutual International Insurance Co Ltd on July 23, 2004.[5]

The FSA may make an administration application in relation to an insurance company.[6] It may also apply to fill a vacancy in the appointment of an administrator in relation to an insurer[7] and the administrator must now send a copy of his Sch.B1 para.49 statement of proposals to the FSA and to the scheme manager of the FSCS.[8]

The powers of an administrator of an insurer are modified as follows:[9]

(1) The powers of the administrator referred to in Sch.1 of the Insolvency Act 1986 include the power to make—
  (a) any payments due to a creditor; or
  (b) any payments on account of any sum which may be due to a creditor.

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[1] See SI 2010/3023, Sch.1 para. 9, modifying para.91(1) of Sch.B1, Insolvency Act 1986.
[2] SI 2002/1242.
[3] As defined in art.2 of the Financial Services and Markets Act 2000 (Insolvency) (Definition of "Insurer") Order 2001 (SI 2001/2643).
[4] Folksam International Insurance Company (UK) Ltd.
[5] See *AA Mutual International Insurance Co Ltd, Re* [2004] EWHC 2430 (Ch); [2005] 2 B.C.L.C. 8.
[6] FSMA 2000 s.359.
[7] IA 1986 para.91(1) of Sch. B1.
[8] Sch.B1 para.49(4)(d) was inserted as a modification for this latter purpose by the Financial Services and Markets Act 2000 (Administration Orders Relating to Insurers) Order 2010 Sch.1 para.3.
[9] See SI 2010/3023.

(2) Any payments to a creditor made pursuant to (1) above must not exceed, in aggregate, the amount which the administrator reasonably considers that the creditor would be entitled to receive on a distribution of the insurer's assets in a winding-up.

(3) The powers conferred by (1) above may be exercised until an initial creditors' meeting but may only be exercised thereafter—

(a) if the following conditions are met—

(i) the administrator has laid before the meeting or any subsequent creditors' meeting ("the relevant meeting") a statement containing the information in (4) below; and

(ii) the powers are exercised with the consent of a majority in number representing three-fourths in value of the creditors present and voting either in person or by proxy at the relevant meeting; or

(b) with the consent of the court.

(4) The information referred to in (3)(a)(i) above is an estimate of the aggregate amount of—

(a) the insurer's assets and liabilities (whether actual, contingent or prospective); and

(b) all payments which the administrator proposes to make to creditors pursuant to (1) above;

including any assumptions which the administrator has made in calculating that estimate.

Protection of the public

H16–14 The FSCS, an independent body set up under the FSMA, came into operation on December 1, 2001 when the FSMA came into force. The FSCS, replaces (inter alia) the compensation scheme administered by the Policyholders Protection Board under the provisions of the Policyholders Protection Act 1975. The FSCS is the United Kingdom's statutory fund of last resort for customers of financial services firms authorised by the FSA. It is able to pay compensation if a firm is unable, or likely to be unable, to pay claims against it. The FSCS protects "eligible claimants"[1] (generally individuals and small businesses) who are policy holders under a long-term insurance contract[2] or a relevant general insurance contract[3] (not a reinsurance contract) of authorised insurance companies in relation to "protected claims" which for insurance means a "protected contract of insurance" issued in the United Kingdom (and in certain cases in the EEA, the Channel Islands and the Isle of Man).[4] The FSCS has set the following compensation limits for protected contracts of insurance by reference to the type of policy:

(1) Compulsory insurance (e.g. third party motor insurance), is covered in full.

(2) Non-compulsory general insurance (e.g. home insurance), is covered up to 90 per cent of the claim.

(3) Long-term insurance (e.g. life insurance), is covered up to at least 90 per cent of the claim.[5]

In the case of both general insurance contracts and long-term insurance contracts, the FSCS may secure, if reasonably practicable, the continuity of insurance by

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[1] See FSA Handbook, Compensation, Ch.4.
[2] See FSA Handbook, Compensation Sourcebook, Ch.4.3.2.
[3] See FSA Handbook, Compensation Sourcebook, Ch.4.3.3.
[4] See FSA Handbook, Compensation, Ch.5.4.
[5] See FSA Handbook, Compensation Sourcebook, Ch.10.2.

facilitating the transfer of the insurance business from the insurance company in default and securing the issuing of new contracts by another insurance firm in substitution of the existing policies.[1]

The FSCS has its own dedicated website: see *http://www.fscs.org.uk* for further details.

Accounting records

H16–15 It should normally be the case that for its long-term business a company will have sufficient records to enable policyholders to be identified relatively easily; this should apply whether the business is introduced by brokers or by direct selling. In the case of general business, however, it is common for companies to keep many of their accounting records in the name of the broker through whom the business was introduced and through whom all day-to-day communications relating to the business are usually conducted.

The broker is an agent, whether of the company or of the insured (which will depend on the circumstances of each transaction) and is a principal only in respect of its brokerage and, on occasions, in respect of moneys it may have advanced on behalf of one party to the insurance contract to the other party. In the case of marine insurance,[2]and unless otherwise agreed, the broker is personally responsible for the premium. In *Pacific & General Insurance Co Ltd v Hazell*,[3] it was held that there was no legally binding custom at Lloyd's requiring Lloyd's brokers to pay premium to non-marine underwriters.

Nevertheless, the liquidator of the company has to deal with creditors on a principal-to-principal basis before he can either collect moneys due from insurers or admit their claims to rank for dividend. This aspect becomes particularly relevant in relation to set-off (see H16–19), and in cases where companies deal with insureds (who in the case of reinsurance business will be other companies) through different brokers. As a result financial records and statements which are acceptable to a going concern company and which can satisfy the company's auditors will not be adequate for the purpose of the liquidation and will need to be completely re-written before the liquidator's real task can commence.

In some types of consumer insurance this will not, however, be possible. A company will never know the identity of insureds who hold "coupon" cover for consumer durables or even for holiday travel insurance. This must also be recognised where the legislation normally requires notice to be sent to all actual or contingent creditors.[4] See *Pacific and General Insurance Co v Hazell* on the mechanisms for accounting at Lloyd's by brokers. There are particular accounting difficulties with an insolvent insurer which is both a leading insurer and a reinsurer, especially at Lloyd's where there are different syndicates and different account syndicate institutions.

Under s.386 of the Companies Act 2006 (as with previous Companies Acts), every company must keep adequate accounting records. That is adequate to:

- show and explain the company's transactions,
- disclose with reasonable accuracy the financial position of the company at any time, and

[1] See FSA Handbook, Compensation, Ch.3, s.3.3.

[2] Marine Insurance Act 1906 s.53 (though not in relation to marine treaty reinsurance). See *JA Chapman & Co Ltd (in liq.) v Kadirga Denizcilik ve Ticaret AS* [1998] Lloyd's Rep. I.R. 377.

[3] [1997] L.R.L.R. 65; [1997] B.C.C. 400; [1997] 6 Re. L.R. 157 QBD.

[4] For e.g. IA 1986 s.98(1A)(b), CA 2006, s.896(1).

- enable the directors to ensure that any accounts required to be prepared comply with the requirements of the Companies Act 2006.

  The accounting records must contain entries from day to day of sums received and expended by the company and a record of its assets and liabilities.

  If a company fails to comply with the duty to keep accounting records under s.386 every officer in default commits an offence.[1]

Admission of claims

H16–16 It is one of the peculiarities of the winding up of insurers as distinct from other undertakings that it usually becomes important to reverse liquidators' normal procedure of concentrating first on the realisation of assets and only later, if it becomes material by reference to the value of those assets, to devote attention to the agreement of creditors' claims.

Insurers will almost always purchase reinsurance protection in order to spread the risks which they assume. This applies even to companies who themselves accept reinsurance business, either exclusively or as part of their portfolio. They also will retrocede a part of that business. Relevant features of reinsurance are discussed in H16–18. It will therefore be necessary in the case of an insolvent insurance company for the liquidator to agree and admit claims before he can attempt to recover the appropriate reinsurance monies.

The ascertainment of claims under long-term policies is relatively easy, but this definition which is related to long-term business (for example, life, health and accident) must not be confused with "long-tail" general business which is discussed in H16–17. Where a claim under a long-term policy has fallen due for payment but not been paid either before the date of the winding-up order, or the date of a stop order, the policyholder will be admitted as a creditor without proof for such amount as appears in the records of the company or the liquidator to be due in respect of that claim.[2] In all other cases a policyholder shall be admitted as a creditor without proof for an amount equal to the value of the policy which is determined by a number of actuarial calculations set out in the rules.[3] Except in relation to amounts which have fallen due for payment before the liquidation date or which have been notified to the company before the liquidation date, claims under general business policies will be admitted without proof[4] and, in most cases, for an amount equal to the unexpired portion of the period in respect of which the last premium was paid.[5] Although it is not stated in any UK statute in such terms, upon a winding-up order being made the company effectively ceases to be on risk for any insurance protection which it has undertaken. There is therefore an implied unilateral breach of the insurance contract imposed by the insurance-related legislation; there is no equivalent provision in other insolvency legislation, and it is therefore likely that jurisdictions which follow United Kingdom company and insolvency law (but have no parallel to the insurance winding-up provisions) will allow to be admitted to proof[6] claims in respect of events which occurred after the date of the winding-up order but during the course of the wind-up and before the expiration of the policy.

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[1] CA 2006 s.387.

[2] Insurers (Winding Up) Rules 2001 (SI 2001/3635) rr.7(2) and 8(2).

[3] Insurers (Winding Up) Rules 2001 (SI 2001/3635) Schs 2, 3, 4 and 5. If the company turns out to be solvent, interest on these values may be allowed: *Pearson v Inland Revenue Commissioners* [1980] Ch. 1.

[4] Insurers (Winding Up) Rules 2001 (SI 2001/3635) r.6.

[5] Insurers (Winding Up) Rules 2001 (SI 2001/3635) Sch.1.

[6] *Macfarlane's Claim, Re, Northern Counties of England Fire Insurance Co* (1880) 17 Ch.D. 337.

In the case of insurance protection which is compulsorily imposed by statute, for example by the Road Traffic Act 1988, cover for future events will automatically cease at the moment when the insurer ceases to be authorised.

An anomalous situation may arise in the case of a policy insuring a single event, such as the weather on a certain day which may be insured by the organisers of a function, or the health or life of a judge insured by the parties to a long trial. If the insurer is placed in liquidation between the grant of the cover and the date of the event a pro-rata return of premium is unlikely to be an adequate remedy especially in cases where the nature of the risk may have changed meanwhile.

Equally, problems may arise in the case of policies which do not "run from one definite date to another"[1] of which perhaps the best example would be the voyage of unspecified duration of a ship. As a matter of commercial good sense, an insured will seek to replace his cover from an insolvent insurer as quickly as possible, but in practice this may not be so easy.

In practice, insolvent insurers are most commonly the subject of a scheme of arrangement rather than a liquidation, but such schemes embody by reference most of the liquidation principles.

Contingent and uncertain claims

H16–17 Many of the risks insured under general business policies do not crystallise into quantified claims for a large number of years; environmental pollution, asbestosis and medical negligence are examples. This is known as long-tail business.

Cash shortage is rarely the immediate cause for winding-up; it is more often the failure to maintain the solvency margin (see H16–09), or other recognition that assets are unlikely to be sufficient to meet liabilities including provisions for known and "IBNR" (liabilities "incurred but not reported") claims. Particularly in the case of companies which have insured a substantial amount of long-tail business it is often found that only a relatively small proportion of claims which are entitled to be admitted to proof have actually crystallised at any particular date, including the date of the commencement of the winding-up.

It had been suggested that the wording of Sch.6 to the Insurers (Winding-Up) Rules 1985[2] (the predecessor to the Winding Up-Rules 2001[3]) prevented claims which had not crystallised at the commencement of the winding up from being admitted to proof at all. This would have led to an unmerited windfall either to other creditors or, more probably, to shareholders since most companies which have written a substantial amount of long-tail business and which may be insolvent by reason of actuarial reserving for long-tail liabilities would turn out to be solvent if only crystallised claims need to be paid. This interpretation was rejected by Hoffmann J. in *Transit Casualty Co v Policyholders Protection Board* which held, inter alia, that r.6 and Schedule 1 to the Insurance Companies (Winding-Up Rules) 1985 provided a complete and exhaustive code for the valuation of admissible claims save in relation to claims which had fallen due for payment.[4]. Those otherwise entitled also

[1] Insurers (Winding Up) Rules 2001 (SI 2001/3635) Sch.1 para.3(2)(a).
[2] SI 1985/95.
[3] SI 2001/3635.
[4] [1992] 2 Lloyd's Rep. 358. See also *Scher v Policyholders Protection Board (No.1)*; *Ackman v Policyholders Protection Board (No.1)*; *Royal Insurance (UK) Ltd v Scher*; *Royal Insurance (UK) Ltd v Ackman* [1993] 2 W.L.R. 479 [1992] 2 Lloyd's Rep. 321 CA ; *Hughes v Hogg Insurance Brokers Ltd, Re, Continental Assurance Co of London Plc (in liq.) (No.3), Re* [1999] 1 B.C.L.C. 751; The Times, January 14, 1999, Carnwath J., which confirmed that the Insurance Companies (Winding Up) Rules 1985 (SI 1985/95) applied to voluntary as well as compulsory liquidations. It is clear from the definition of

previously benefited from the provisions of the Policyholders Protection Act 1975[1] (subsequently replaced by the FSCS under FSMA: see now H16–14).

The relatively small number of crystallised claims, referred to above, has two consequences:

(a) it inhibits the payment of any dividend to admitted creditors out of available funds since even the most conservative estimate of further claims could be wrong; and

(b) it delays the collection of reinsurance recoveries. These are often a significant proportion of the company's realisable assets.

As a result it has generally been regarded as unavoidable that the process of winding up at least the general business part of a company may occupy between 10 and 20 years, or more. The Insolvency Rules stipulate that a liquidator must estimate the value of any debt which, by reason of its being subject to any contingency or for any other reasons, does not bear a certain value.[2] There would not appear to be any obvious reason why this mandatory rule should not be applied in the case of the winding up of an insurance business; indeed the Insurers (Winding Up) Rules[3] appear to confirm this. It will almost certainly be necessary to apply actuarial formulae to the estimation process and it may be advisable to invoke the assistance of the court.[4] It is arguable that where a claim is determined by the liquidator in this manner as a result of which the claimant will receive a dividend earlier than he would have received payment from the company were it not being wound up, the rules relating to discounting should be applied.[5] The use of this procedure which has been approved in the Supreme Court of Bermuda[6] and the High Court of the Republic of Ireland also has the result that the estimation process effectively determines the amounts due by reinsurers earlier than if the normal claims investigation process were allowed to run its course. The implications of this are discussed in H16–18 and H16–19 relating to reinsurance and set-off.

Alternatively policyholders and other creditors may be asked to agree to a scheme of arrangement[7]to achieve a similar purpose: See F1.

In some cases the company may have accepted only a part (known as a "line") on a particular risk. In that event there will usually be a lead underwriter who will have most of the responsibility for agreeing the amount of any particular claim and the other insurers will follow his decision. The liquidator will not necessarily regard himself as bound by this arrangement. He may accept it passively without such active participation as sharing the cost of investigation or litigation; he will know that the other insurers will take all required steps for their own benefit even if he does not pay his share so that he can ride on their back. However, if the estimation procedure is used the liquidator will effectively accept the company's proportion of the claim at a different amount and presumably far earlier than the company's co-insurers. It is suggested that this is another reason for obtaining the directions of the court for the estimation procedure although r.4.86(1) of the Insolvency Rules 1986 would appear to make it mandatory. The liquidator will not want to expose himself to an accusation of having pre-empted his co-insurers' decision about the admissibility of a claim to which an actuarial formula may attribute a value whether legally justified or not.

"liquidation date" that the Insurers (Winding Up) Rules 2001 (SI 2001/3635) apply to both voluntary as well as compulsory liquidations (see r.2).

[1] *Milton R. Ackman v Policyholders Protection Board* [1993] 3 W.L.R. 357.

[2] Insolvency Rules 1986 r.4.86(1).

[3] Insurers (Winding-Up) Rules 2001 (SI 2001/3635) Sch.1 para.3(2)(b).

[4] IA 1986 s.112.

[5] Insolvency Rules 1986 rr.4.94 and 11.13.

[6] *Cambridge Reinsurance Ltd, Re* unreported, December 6, 1988; *United Reinsurance Company Ltd, Dublin Reinsurance Company Ltd, Re* unreported, 1990. For a detailed discussion of the provisions of the *Cambridge, Re* order, see *A Company (No.013734 of 1991), Re* [1992] 2 Lloyd's Rep. 415 at 426–422.

[7] CA 2006 Pt 26.

Reinsurance

H16–18 Reinsurance may be placed on a "facultative" basis which will cover specific risks which a company has assumed, or on a "treaty" basis whereby certain types of risk which the company has assumed are reinsured without the reinsurer necessarily knowing the full details of each risk for which he has granted cover. Treaty reinsurance takes two main forms, although variations will be numerous:

(a) quota share—whereby the reinsurer assumes a proportion of the risks written by the company for a particular class and/or year of business; and

(b) excess of loss—whereby the company reinsures particular risks or classes of risks to the extent that claims thereunder exceed a specified amount. This excess of loss protection may cover the full amount of the risk written by the company, so that it will also enure for the benefit of the quota share reinsurers of that risk, or it may be worded so as to cover only the company's own retention.

Reinsurers will themselves generally reinsure part of the risk they have accepted; this is known as retrocession. In this way a company, even where it has accepted a risk in full rather than only a proportion or "line" in the first instance may retain for its own account only a relatively small part. In other cases a company may be asked by another insurer to accept a risk on terms by which that other insurer agrees to accept a cession of one hundred per cent. This "fronting" may occur for a variety of reasons, including perhaps the absence of authorisation[1] on the part of a foreign company or a perceived preference for a particular insurer on the part of an insured when that insurer does not really want the business. Even when the fronting is known to all parties, the insurer named in the contract is liable to pay claims despite the fact that the company to which it "reinsured" 100 per cent of the risk is in insolvent liquidation.[2] That insurer will, of course, be able to prove in the liquidation according to the terms of the fronting contract. Conversely, as stated in H16–23 the rights conferred by the Third Parties (Rights Against Insurers) Act 2010 do *not* extend to reinsurance protection. The liquidator of the insolvent insurance company will admit claims to proof and will pay the appropriate rate of dividend thereon. He will also seek to claim from the company's reinsurers the full amount due under the reinsurance contract.[3] The admission of a claim may thus result in a cash profit to the liquidation estate, depending upon the respective rates of dividend and reinsured percentage. However, the courts in the USA appear now to be examining the precise nature and wording of fronting and reinsurance contract more closely and have held in one case[4] that an insured with an insolvent fronting insurer may be entitled to recover direct from the reinsurer. Different states take different approaches.

Many contracts of reinsurance give the reinsurer the right to be consulted over claim settlements or to intervene in and even take over litigation. This offers valuable protection to the reinsurer against a liquidator tempted to admit claims for an excessive amount either because the cost of litigation, which has to be paid in full as a liquidation expense, is not justified where the percentage dividend ultimately payable on the claim may only be negligible or in order to make the "profit" for the

[1] FSMA 2000 s.19.

[2] *Eagle Star Insurance Co v Yuval Insurance Co* [1978] 1 Lloyd's Rep. 357.

[3] *Eddystone Marine Insurance Co, Re, Ex p. Western Insurance Co* [1892] 2 Ch. 423, and *In Re Law Guarantee and Accident Society Ltd, Liverpool Mortgage Co's claim* [1914] 2 Ch. 617.

[4] *Venetsanos v Zucker, Facher & Zucker* (1994) 271 N.J. Super. 459, 638 A.2d 1333, 1994 N.J. Super. LEXIS 83 (App. Div. 1994); Cert denied, 137 N.J. 166, 644 A.2d 614, 1994 N.J. Lexis S35 (1994). This case has been the subject of additional litigation, especially in the Pennsylvania courts. See, in particular, *Koken v Reliance Ins. Co.*, No 269 M.D. 2001, Commonwealth Court of Pennsylvania 84 A.2d 167; 2004 Pa. Commw. LEXIS 250 *Koken v Legion Ins. Co.*, 831 A.2d 1196 (Pa. Cmwlth. 2003).

estate by increasing his reinsurance recovery. However, the reinsurer's ability to intervene in litigation is severely restricted.[1]

It must however be said that this is still one of the most controversial areas of insurance insolvency. Many reinsurance contracts, especially excess of loss contracts, indemnify the reassured in respect of the excess of an ultimate net loss over a specified amount. The term "ultimate net loss" is then defined as the sum actually paid by the reassured in respect of any loss occurrence including certain expenses and deducting certain recoveries. The former controversy regarding the meaning of the phrase "actually paid" has been settled, in a satisfactory manner from the point of view of liquidators, by the decision of the House of Lords in *Charter Reinsurance Co Ltd (in liq.) v Fagan*.[2] Relying upon the ordinary meaning of the words "actually paid"[3] and the principle of indemnity which applies generally to contracts of insurance and reinsurance, some reinsurers had sought to limit their liability by reference to the dividend paid in the liquidation instead of the amount admitted to proof. It was suggested that were such an argument to have succeeded it would have led to the unjust enrichment of the reinsurer who had received premium based on the risk he had accepted without regard to the possibility of the insolvency of the reinsured company reducing the amount actually paid on the insured claim. More importantly, if this argument had been accepted by the courts it would almost certainly have resulted in an appraisal of the extent to which reinsurance protection could be allowed as a permissible deduction from liabilities[4] in calculating a company's margin of solvency. The House of Lords construed the words "actually paid" so as not to require payment on the part of the reinsured as a condition precedent to liability on the part of the reinsurer.

In the USA, where insurance winding-up is based upon state rather than federal law, there have been conflicting decisions on the interpretation of similar clauses. In New York for instance, following a decision adverse to the liquidator,[5] who was the State's Superintendent of Insurance, legislation was passed which effectively reversed that decision by stating that unless the reinsurance contract provides for payment without diminution because of the insolvency of the ceding underwriter credit for that reinsurance will not be allowed in calculating the solvency of insurers. This would also deal with cases where the wording attempts to put the matter beyond doubt, so as for instance, to state definitely that if the insurer for any reason including its own insolvency does not pay the whole of a claim the reinsurers shall only pay the same proportion.[6]

Many reinsurance contracts contain an arbitration clause, one of the terms of which is an "honourable engagement clause" usually providing that the arbitrators should "interpret this reinsurance as an honourable engagement and they shall make their award with a view to effecting the general purpose of this reinsurance in a reasonable manner rather than in accordance with a literal interpretation of the language". The courts have at times held that this type of clause is meaningless and

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[1] *Meadows Indemnity Co Ltd v Insurance Co of Ireland Plc, International and Commercial Bank Plc.* [1989] 1 Lloyd's Rep 181.

[2] [1997] A.C. 313; [1996] 2 W.L.R. 726; [1996] 3 All E.R. 46; [1996] 2 Lloyd's Rep. 113 HL. The *Appeal Cases* law report contains the decisions of Mance J. and the Court of Appeal, together with the decision of the House of Lords.

[3] See the robust dissent of Staughton L.J. in *Charter Reinsurance Co Ltd (in liq.) v Fagan* [1997] A.C. 313 at 357–358.

[4] Insurance Companies Regulations 1981 (SI 1981/1654) Sch.1 para.13.

[5] *Fidelity and Deposit Company of Maryland v Pink*, 302 U.S. 224, 58 S. Ct. 162, 82 L. Ed. 213(1937).

[6] *Nepean v Marten* [1895] 11 T.L.R. 256. See also *Charter Reinsurance Co Ltd (in liq.) v Fagan* [1997] A.C. 313; [1996] 2 W.L.R. 726; [1996] 3 All E.R. 46; [1996] 2 Lloyd's Rep. 113 HL.

that a question of law must remain a question of law.[1] The Arbitration Act 1996 s.46(1)(b) empowers the arbitrators to decide the dispute in "accordance with such other considerations" as the parties may agree, and it appears that "honourable engagement" clauses are unlikely in the foreseeable future to be open to challenge in terms of validity, although the scope of such clauses remains an issue. In one of the last cases on "honourable engagement" clauses decided under the former arbitration legislation the court stayed an action in which a reinsurer claimed a declaration that it was not liable to pay the insolvent insured until the latter had paid up under the original insurance. The court held that the arbitration should first proceed[2] and the same liquidator was successful in an arbitration with another reinsurer who did not first seek to prevent it taking place.

If the liquidator uses the estimation procedure described in H16–17 for determining the amounts of unagreed or contingent claims, and even if he obtains the approval of the court to do so, reinsurers as debtors to the company will not necessarily be bound by his determination. The rule applies to determination of the claims of creditors and does not necessarily have any consequential effect on debtors who may well not have had an opportunity to be heard. It is therefore likely that the liquidator will be left to his negotiating skills to recover what should reasonably be due. A reinsurer who is also a creditor under another contract may however be bound in his creditor capacity when set-off is applied, as discussed in H16–19.

Set-off and insurance companies

H16–19 The principles of set-off as applying to winding-up generally are discussed in E3–28. Where an administration order has been made in relation to an insurer, and the insurer subsequently goes into liquidation, sums due from the insurer to another party are not to be included in the account of mutual dealings rendered under r.4.90 of the Insolvency Rules 1986 if, at the time they became due, in relation to the insurer: either an administration application had been made under Sch.B1 para.12 of the Insolvency Act 1986, or a notice of appointment of an administrator by a qualifying floating chargeholder under Sch.B1 para.14 had been filed in court under Sch.B1 para.18, or a notice of intention to appoint an administrator by the company or its directors under Sch.B1 para.22 had been filed with the court under Sch.B1 para.27.

The intricate web woven by the insurance industry whereby companies and Lloyd's syndicates frequently participate in each other's business in a variety of contracts of co-insurance, reinsurance, retrocession and beyond, usually placed through numerous different brokers, makes set-off a particularly important issue in insurance insolvency. Thus company A may reinsure part of a risk with company B through broker X, and may accept a retrocession of part (or whole) of a completely different risk from company B through broker Y.

As explained in H16–15 the company may have maintained its accounting records on a broker by broker basis and may have settled net balances with that broker by payments to or from him at regular intervals. The broker may also have funded the payment of claims to insureds on behalf of the company through this accounting system. When winding up commences this accounting process has to stop, as thereafter the liquidator has to deal with principals and not agents for all future events, which may include premium adjustments as well as claim agreements. Accounts settled prior to the commencement of the winding up will not be disturbed but for

[1] *Orion Compania Espanola de Seguros v Belfort Maatschappij voor Algemene Verzekgringeen* [1962] 2 Lloyd's Rep. 257.

[2] *Home & Overseas Insurance Co v Mentor Insurance Co (UK)* [1989] 3 All E.R. 74.

business not already settled the accounts must be rewritten as mentioned in H16–15 so that correct balances may be established and set-off may be properly applied. As pointed out in H16–17 there will be a substantial quantity of claims not agreed at the commencement.

When dealing with the remaining account of the broker the liquidator will not admit for set-off any funding of claims, expenses or premium which the broker may have voluntarily undertaken after the date of the last settled account. Unless the broker has obtained an assignment only the principal can be admitted to proof and the broker must make his peace with him as best he can. Post-commencement assignments cannot be admitted under any circumstances.[1]

It is common practice in reinsurance treaties for the reinsured to be permitted to maintain a premium reserve fund in which a proportion of the premium due by him is held, effectively as security for the payment of claims which may become due to him. The reason may not merely be a wish by the reinsured to protect himself against the reinsurer's inability to pay; he may be compelled to do so by the regulatory authority or legislation in certain countries if the reinsurer is outside that country and the reinsured wishes to have the reinsurance protection recognised for calculating his solvency margin. In other cases the same object may be achieved by the issue of letters of credit by a bank in the country of the reinsured. The letter of credit is then generally, but not always, secured to the bank by the reinsurer through the deposit of funds or marketable securities. In the event of the liquidation of the reinsurer the reinsured will be entitled to look to the reserve fund or draw on the letter of credit as security for the reinsurer's liability to him in respect of the particular cover or treaty for which the arrangement was created. It appears that if thereafter there remains a balance in favour of the insolvent reinsurer which may consist of both principal and interest earned on the fund the reinsured will be entitled to set-off the interest against other debts owed to him by the insolvent company as it represents a general debt covered by the provisions of r.4.90 of the Insolvency Rules 1986. Any surplus on the principal sum which had been allowed or given as security is not a debt arising from mutual dealings and should therefore be paid to the liquidator.[2]

The relevant date for the taking of the account[3] is the commencement of the winding-up. For this purpose contingent debts and debts of uncertain value may be included.[4] This will apply whether the estimation procedure discussed in H16–11 is used, either as the result of an application to the court or as part of a scheme of arrangement[5] or whether the agreement of claims is allowed to take its normal course. It is considered that interest earned after the commencement on funds retained cannot constitute debts at that date, and that therefore these must also be available to the liquidator. It must, however, be recognised that strict application of this regime may not be possible, or at least may not be cost-effective where a liquidator of a company is dealing with pools (see H16–22) or Lloyd's syndicates. The membership of the pool or syndicate may vary from year to year and individual names will be members of a large number of syndicates. As a result there is often no practical alternative to treating pools and syndicates as principals for the purpose of applying set-off.

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[1] Insolvency Rules 1986 r.4.90(3). For a wider discussion of funding see *Merrett v Capitol Indemnity Corp* [1991] 1 Lloyd's Rep. 169.

[2] *City Equitable Fire Insurance Co Ltd (No.2), Re* [1930] 2 Ch. 293. See the article by Gabriel Moss QC and Lloyd Tamlyn in (1993) 6 *Insolvency Intelligence* 73–75.

[3] Insolvency Rules 1986 r.4.90(2).

[4] *Charge Card Services Ltd, Re* [1986] 3 W.L.R. 697.

[5] CA 2006 Pt 26.

Cross-frontier problems

H16–20 The majority of companies which do not confine themselves purely to what might be called domestic consumer business, such as, for example, motor or householder insurance, operate in an international market of which London is one of the most prominent centres. Part VI of the Winding-Up Regulations applies "relevant measures" (winding-up, administration) to a "third country insurer", defined as a person with permission under the FSMA to carry out contracts of insurance and whose head office is not in the UK or an EEA State. So where a third country insurer is subject to a relevant measure, then Pt III (modifications of the law of insolvency: notification and publication), Pt IV (priority of payment of insurance claims in winding-up etc.), and Pt V (reorganisation or winding up of UK insurers: recognition of EEA rights) of the Regulations apply. See H16–07.

In several jurisdictions, although not in the United Kingdom, foreign companies, which for that purpose will include British companies, may as a condition of being allowed to conduct insurance business be required to furnish security, by way of deposits with either a bank or the regulatory authority, or of letters of credit. In the event of insolvency these deposits will only be available for the creditors resident in that country. These creditors will still be entitled to prove in the liquidation but it is considered that they must under English law give credit against their dividend for any payment they may have received out of the distribution of that deposit.

Foreign companies authorised to carry on insurance business[1] will usually be "overseas companies" incorporated outside the UK that have opened a UK establishment (whether a place of business or a branch) so as to require registration,[2] and thus become subject to winding-up proceedings. As explained in F1–20, foreign companies may be wound up as unregistered companies pursuant to s.221(5) Insolvency Act 1986. For instance, in the USA the claims of reinsurance creditors are typically postponed to those of policyholders. It is therefore unlikely that the court would permit the English liquidation of a US company to be treated as an cillary; indeed even US reinsurance creditors might prefer the proceedings to remain separate so as to enable them to prove on a pari passu basis against at least some of the company's assets. In *The Home Insurance Co, Re*[3] the English court sanctioned a scheme of arrangement of a US insurance company that was in liquidation in the US and in provisional liquidation in England, in relation to its business in the UK (and in that regard the scheme creditors in the UK unanimously approved the scheme) on grounds of comity with the US court and without seeking to trespass on matters germane to the US court (where an appeal on separate matters was pending).

Other countries may apply yet other differentiations in their treatment of creditors so as to make completely separate proceedings in the UK more attractive to some policyholders.

On the other hand, if there is a sufficient commonality of interest it may be possible to overcome conflicts of law by use of a scheme of arrangement[4] to achieve a joint operation as well as separation. It is possible for a scheme of arrangement to apply anyway to a foreign insurance company as an unregistered company. See F1–20.

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[1] FSMA s.19.

[2] CA 2006 s.1044 and Overseas Companies Regulations 2009 Pt 2 (SI 2009/1801). "Overseas companies" under the CA 2006 have replaced the concept of "overseas companies" under the CA 1985 which were companies incorporated outside Great Britain which had established a place of business in Great Britain. The change was necessitated partly to bring Northern Ireland companies (Northern Ireland is outside Great Britain) within the CA 2006 applying throughout the UK.

[3] [2005] EWHC 2485 (Ch); [2006] B.C.C 164.

[4] CA 2006 Pt 26.

H9–01 discusses the rights given to foreign representatives by Ch.15 of the United States Bankruptcy Code. Chapter 15 replaced the previous procedure (under s.304 of the United States Bankruptcy Code) in 2005. Chapter 15 expressly recognises "foreign insurance companies" as eligible to seek assistance in the United States in connection with a foreign proceeding. Although the provisions of Ch.15 became effective only as of October 17, 2005, the Bankruptcy Court for the Southern District of New York has recognised several solvent schemes of arrangement of foreign companies in run-off, as foreign proceedings entitled to Ch.15 relief.[1]

On a cross-frontier matter, an English court exercising insolvency jurisdiction may assist a foreign court in "any relevant country or territory" under s.426 of the Insolvency Act 1986 and the Secretary of State may by order designate countries whom the English court will assist on a request to do so. For a leading case see the House of Lords' decision in *McGrath v Riddell*[2] where the House of Lords authorised English provisional liquidators of an Australian insurance company (the HIH group) to hand over assets collected in an auxiliary winding-up in England to the Australian liquidators despite the fact that Australian law would allow distribution of the assets not in accordance with the pari passu principle of English law. Interestingly, Lord Hoffmann believed that the English court had an inherent power to do this anyway on principles of judicial comity without recourse to s.426. Lord Scott vehemently disagreed with this approach . Lord Hoffman's approach may also be followed in the case of liquidations in jurisdictions not recognised under s.426.

Insolvency proceedings (brokers)

H16–21

Brokers are subject to all usual insolvency and recovery routes available under the Insolvency Act 1986. However, there are also certain requirements in the Insurance Mediation Directive[3] which are designed to protect clients in the event of the broker's insolvency. The Directive provides a set of "conduct of business" rules for the sale of insurance products to ensure a basic harmonised level of consumer protection throughout the EU. All individuals or companies who carry out insurance or re-insurance mediation in the EU are required to register in their home state. The requirement to segregate funds received from or on behalf of clients and keep them separate from the broker's own funds has been implemented through the Client Money Rules, which appear in the FSA's Client Assets Sourcebook. Client funds may be held either through a statutory or a non-statutory trust or on a "risk-transfer" basis (which would only apply where the broker is acting as agent for an insurer). Where the funds are held through a trust, they will not form part of the broker's insolvent estate and will not be available for distribution to its unsecured creditors. Instead, money held in the client accounts will be pooled and distributed rateably among clients in accordance with their "client money entitlement" as set out in the Client Money Rules. The object of segregating funds in this way is to ensure that both insurers and insureds receive the money to which they are entitled, but it should be noted that under the Client Money Rules, insurers' claims rank lower in priority than claims of the broker's other clients.

If the statutory or non-statutory trusts fail for any reason, the principle in *Neste*

[1] See, e.g. In *re Tokio Marine Europe Insurance Limited*, Case No. 11-13420 (Bankr S.D.N.Y 2011); In *re Allianz Global Corporate & Specialty (France) et al*, Case No. 10-14990 (Bankr. S.D.N.Y. 2010); In *re Grey Friars Insurance Company Limited, et al*, Case No2. 07 - B - 12934 (Bankr. S.D.N.Y. 2007); In *re Oslo Reinsurance Co. (UK) Ltd and Oslo Reinsurance Co. ASA*, Case No. 07-12211 (Bankr. S.D.N.Y. 2007).

[2] [2008] UKHL 21; [2008] B.C.C. 349.

[3] Directive 2002/92/EC of the European Parliament and of the Council of 9 December 2002 on insurance mediation.

Oy may be of assistance.[1] *Neste Oy* suggests that sums which have been paid to a broker after the broker is aware that it has become insolvent may be regarded as being held on trust so long as they are still identifiable. This would apply even if the broker had mixed the client funds with its own money.

It should also be noted that while unpaid premiums generally appear in brokers' balanc e sheets in the form of debts due from clients and liabilities owed to insurers, they are not genuine debts in the majority of cases. In relation to unpaid premiums, the client's real creditor is the insurer rather than the broker so in this case an insolvent broker will simply drop out of the picture. However, the position is different with respect to marine insurance, since a broker effecting marine insurance for his client is directly responsible to the insurer for the premium, but is not responsible for claims or return premium.[2] He has a lien over the policy for the premium and his charges.[3] If a broker becomes insolvent, the marine insurer does have a claim as a creditor in the proceedings but the liquidator or trustee can collect that premium in full from a client who had not previously paid. The same applies to a Lloyd's broker, who is responsible to Lloyd's for premiums irrespective of whether the insured has paid.

In light of the above considerations and the fact that the FSA Client Money Rules do not apply to brokers' reinsurance activities or to large risks (e.g. marine or aviation) situated outside the EEA, it becomes important to establish the exact status of the broker in respect of every type of transaction which it conducted. If a broker's activities do fall outside of the Client Money Rules, it can still elect to comply with them. However, if it does not elect to do so, the question of which party bears the credit risk for the broker's insolvency will be determined either by the relevant contractual provisions or by statute.

If insurance brokers have funded claim or premium payments on behalf of insolvent companies, this funding may equally cause problems to the liquidator of a broker. The client of the broker will not necessarily know that funding has taken place so that the broker may wish to assert rights as a principal instead of purely as an agent. The liquidator will nevertheless seek to recover the funded payment from that former client if he is unable to do so from the insurer concerned.

Goodwill is an important asset of a broker but may at times be difficult to realise. Most agency agreements between companies and brokers give the company the right to terminate the agency upon insolvency. The company may wish to exercise that right in order to protect the interest of its insureds, it may equally well seek to do so in order to appropriate what should be the broker's goodwill for its own benefit. Insurance broking is a largely personal business, and it is not unusual for the purchaser of the goodwill of an insolvent broker to base the consideration on the extent of the business which he actually succeeds in retaining instead of paying a fixed amount.

Insurance Pools

H16–22 Pooling is a method of spreading risk whereby a syndicate or collection of insurers, writing a specific class of business, agree to shape the premiums and losses in agreed proportions.

It is common for companies to allow proportions of certain types of risk to be accepted on their behalf by managers, frequently brokers, of "pools" who undertake

[1] *Neste Oy v Lloyds Bank Ltd* [1983] 2 Lloyd's Rep 658.
[2] Marine Insurance Act 1906 s.53(1).
[3] Marine Insurance Act 1906 s.53(2).

this operation for several companies, thus in total accepting 100 per cent of the risk. The pool managers will undertake the whole range of the work involved, from acceptance of the risk to agreement of claims or handling of related litigation. They will often sign "for and on behalf of XYZ [*their own name*] pool" without necessarily even disclosing the names of the pool members, that is the actual insurers, and these may vary from risk to risk and from year to year. Under UK law the mere presence in the UK of the pool manager makes the operation of the pool subject to authorisation[1] under UK law.[2] In such cases the presence of one authorised insurer as a pool member may mean that this insurer will have to "front" for others, with the result mentioned in H16–18.

If a member of the pool is wound up, the liquidator will treat the company's obligations in respect of pool business in exactly the same way as all other claims, except that he may not know who his potential creditors are; he may therefore seek to deal with the pool manager on their behalf.

In the event that the pool manager is wound up the problems will multiply. The manager's insolvency should have no effect upon the insureds, who are entitled to look to the pool members for payment if they can discover who these are. The members may or may not have already paid the pool manager, whose insolvency will quite possibly have been caused by some pool members failing to meet their obligations and having used either other members' or else his own monies to meet the defaulters' share of the business. Where the manager still holds monies at the commencement of the winding-up the liquidator may be faced with a variety of alleged trust or tracing claims. The task of identification of the source of these monies may be impossible, the cost of doing it will probably be prohibitive and out of proportion to the sums involved. It would seem to be certain that only the pool members and not the insureds can claim upon the manager's assets. The latter's remedy should be against the members direct.

The most he can expect as benefit will be the collection of management fees due under the original contracts and the recovery of advances which the manager had made on behalf of members. There may be little prospect of this being advantageous to the creditors and the liquidator will in those circumstances abandon the operation and leave the pool members to fend for themselves. They in turn will all want access to the same records which are in the possession of the liquidator and may therefore seek a successor to the manager even if only to wind down the pool.

The liquidator of the manager will be reluctant or even unable to conduct the run-off of the pool.

For an example of a scheme of arrangement under (what is now) the Companies Act 2006 Pt 26 of a group of companies which underwrote insurance and reinsurance business in pooling arrangements (the Willis Faber Underwriting Management Pools) see *Sovereign Marine & General Insurance Co Ltd, Re*.[3]

Third parties and the 1930 Act

H16–23 The Third Parties (Rights Against Insurers) Act 1930 was introduced together with the Road Traffic Act 1930, and grants to an injured party the right to claim directly on an insurer, even if the tortfeasor is insolvent. It is not limited however to road traffic cases and has general effect, and prevents the injustice of a claim being made by an insolvency practitioner for the estate generally, leaving the injured party

[1] Formerly Insurance Companies Act 1982 ss.2–4; now FSMA 2000 s.19(1).
[2] *DR Insurance Co v Seguros America Banamex* [1993] 1 Lloyd's Rep. 120.
[3] [2006] EWHC 1335 (Ch); [2006] B.C.C. 774.

as an unsecured creditor. To the extent that an insurer can assert rights against the insured, for example for non-disclosure, the third party is in no better position.

It was amended[1] by the Insolvency Act 1985, and again by the Insolvency Act 1986, and now extends to voluntary arrangements *and* to administrations. It does not apply to reinsurance contracts.[2] The Law Commission's Report No.152 recommended substantive reforms and to an extent these will be implemented by the Third Parties (Rights Against Insurers) Act 2010 which from a time to be appointed by statutory instruments will replace the 1930 Act.

There are statutory obligations[3] on insolvency practitioners to provide information to injured parties seeking to benefit from this legislation. In the Court of Appeal decision in *First National Tricity Finance Ltd v OT Computers Ltd* [2004] EWCA Civ 653, the Court of Appeal held, inter alia, that a third party had a right under the 1930 Act to obtain information from the insured and the insurers prior to establishing the liability of the insured. Prior to that decision, there was no obligation on a defendant to assist an injured party before that defendant's liability had been established.[4] The injured party is not directly concerned by any policy obtained by an insolvent company or individual, he merely has the right to seek to enforce it, the insurers being able to raise any defences they might have had. This means that the injured party had first to succeed in a claim against the insolvent insured, and then secondly against the insurers.[5]

The existence of a possible claim under the Third Party (Rights Against Insurers) Act 1930 has been held to be a sufficient "asset" with the jurisdiction to enable a winding-up order to be made in respect of an overseas company, thereby triggering the right to pursue the claim directly against the insurers.[6]

Unlike the position which will apply when the Third Parties (Rights Against Insurers) Act 2010 is in force, under the Third Parties (Rights Against Insurers) Act 1930, where the insured company is dissolved before an action had been started the claimant is unable to sue the insurer unless the company is restored to the Register of Companies. However, the court may not make such order if it appears that the proceedings would fail by reason of being time barred under the Limitation Act 1980. The latitude allowed to the court by that Act has been considered by the Court of Appeal.[7] Ship owners frequently enter into mutual insurance arrangements commonly known as P&I clubs. Whilst the precise wordings of the club rules may vary, it is a feature common to many of them that a member is entitled to be indemnified by the club against any claims "which he shall have become liable to pay and shall in fact have paid".

These words were considered by the House of Lords in *Firma C-Trade SA v Newcastle Protection and Indemnity Association*,[8] when it was held that the P&I club had no liability under the 1930 Act to third party claimants because under the rules of the club, members had no right to be indemnified until they had paid the third party claimants.

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[1] It is printed in its amended form in Vol.3.

[2] Third Parties (Rights Against Insurers) Act 1930 s.1(5). See also *Farrell v Federated Employers' Insurance Association* [1970] 1 W.L.R. 1400 and *Murray v Legal and General Assurance Society Ltd* [1970] Q.B. 495 as to the interrelationship of the claimant and insurer.

[3] Third Parties (Rights Against Insurers) Act 1930 s.2, as amended by the IA 1985 and the IA 1986.

[4] *Nigel Upchurch Associates v Aldridge Estates Investment Co* [1993] 1 Lloyd's Rep. 535. See also *Woolwich Building Society v Taylor* [1995] 1 B.C.L.C. 132. Both of these decisions were overriden by the Court of Appeal decision in *First National Trinity Finance Ltd v OT Computers Ltd* [2004] EWCA Civ 653.

[5] See *Post Office v Norwich Union Fire Insurance Society Ltd* [1967] 2 Q.B. 363; *CVG Siderurgicia del Orinoco SA v London Steamship Owners Mutual Insurance Association Ltd (The Vainqueur Jose)* [1979] 1 Lloyd's Rep. 557; *Pioneer Concrete (UK) Ltd v National Employers Mutual General Insurance Association Ltd* [1985] 1 Lloyd's Rep. 274.

[6] *Compania Merabella San Nicolas SA, Re* [1973] 1 Ch. 75.

[7] *Workvale Ltd (No.2), Re* [1992] 2 All E.R. 627.

[8] [1990] 2 All E.R. 705.

It would therefore appear that the existence of the Third Party (Rights Against Insurers) Act 1930 can work against the interest of an injured party.

The rights conferred by the Third Parties (Rights Against Insurers) Act 1930 do not extend to enabling persons insured by an insurer in liquidation to recover direct under the insurer's reinsurance protection.[1] If A has a judgment against B for damages in respect of which B is insured and becomes bankrupt, or being a body corporate goes into insolvent liquidation, A can recover the amount of that judgment direct from B's insurer. If, however, A has a claim against an insolvent insurer in respect of which that insurer has reinsured himself for the whole or part of the risk then A has no right to look direct to the reinsurer(s) for payment. In the USA, "cut through" agreements are permitted so that the direct right to reinsurance protection is established by contract. It is considered that in England such an agreement may not amongst other things necessarily create privity and may potentially offend against the pari passu principle discussed in E3–01. Such clauses remain relatively untested by the courts.

The complex interaction of the 1930 Act and Lloyd's was considered in *Cox v Bankside Members Agency Ltd*[2]. The decision by the Court of Appeal in 1995 upheld the "first past the post" approach where the totality of claims exceeded policy limits.

As mentioned above, the Third Parties (Rights Against Insurers) Act 1930 is to be repealed and replaced by the Third Parties (Rights Against Insurers) Act 2010 from a date to be appointed by statutory instrument.

The changes to be effected by the 2010 Act when in force include:

- A new court procedure will be available providing third parties with a right to seek declarations as to the insured's liability to the applicant and as to the insurer's potential liability under the insurance contract in a single set of proceedings. If the court or tribunal makes such declarations, it will be able to make an appropriate judgment which is likely to be a money judgment. This mechanism is not mandatory and the third party may, as under the 1930 Act, still bring proceedings against the insured before commencing proceedings against the insurer.
- The third party will no longer be obliged to join the insured in proceedings against the insurer (if this is not done where a declaration is made regarding the insured's liability to the third party, it will not bind the insured).
- Changes to reflect developments in insolvency and companies legislation.
- Voluntarily-incurred liabilities such as liabilities covered by legal expenses and health insurance are expressly provided for: there was some doubt as to whether the 1930 Act applied to such liabilities.
- The regime governing a third party's ability to seek information will be clarified; a list of disclosable information is in the Act; the third party will be able to seek information from certain persons on the basis of a reasonable belief that they have received a transfer of rights under the legislation.
- The duty to disclose will arise only on the third party's request, and there is no continuing duty on the disclosing party to monitor information relevant to the third party's claim. Further, the disclosing party will only be required to disclose specified information but will not be required to provide specific documents.
- A number of enhancements to the third party's rights are introduced (e.g. a third party will be able to fulfil the insured's contractual duties (conditions) such as notice of claim matters such as a claim as if done by the insured; conditions requiring the insured to provide information or assistance to the insurer which is a dissolved company will have no effect; pay-first clauses will be of no effect after a statutory transfer of rights).

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[1] Third Parties (Rights Against Insurers) Act 1930 s.1(5).

[2] [1995] 2 Lloyd's Rep. 437 CA.

- The cross-border element is clarified: if the insured has entered insolvency proceedings in the UK, the 2010 Act will apply. Liability does not depend on any other connection with the UK.