Hot Topic: Proposed UK Insurer Resolution Regime

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There is currently no statutory resolution framework for UK insurers, similar to the UK framework for banks. HM Treasury is therefore increasingly concerned that existing processes available to assist struggling insurers are insufficient and do not allow authorities to act swiftly to stabilise failing entities and minimise potential risk.

Key recent developments

- In January 2023, HM Treasury launched a consultation proposing the establishment of a UK framework for the resolution of insurers, the Insurer Resolution Regime ("IRR").
- The Government's August 2023 response outlined its plans to legislate when parliamentary time allows and to set out further information in due course.
- Echoing the objectives of the existing UK special resolution regime for banks under the Banking Act 2009, the proposed IRR would equip the Bank of England with several new tools to manage the failure of a systemic insurer more quickly.
- Intended to "protect the wider economy, and minimise disruption to policyholders in the event of a systemic insurer failure", the Government's overall objective when considering the IRR "has been to preserve the stability of the UK's financial system … and ensure the UK remains a world leader in the design of its regulatory framework for insurers".
- The proposals follow an International Monetary Fund recommendation that the UK should establish a resolution framework for insurers and implement various relevant international standards.
- Although the consultation closed some time ago, it remains unclear when the new regime might become law.

What does it mean for pension scheme trustees?

For pension scheme trustees, the proposed regime could potentially prove helpful in risk transfer transactions, as the Bank of England would have the ability to transfer the business of a failing insurer to another insurer more quickly and easily (ie without court approval, as is currently needed for a transfer under Part VII of the Financial Services and Markets Act 2000). This could create greater stability, and subsequent success, for such transactions.

However, key questions for trustees contemplating a buy-in, and subsequent buy-out, include:

Bail-in

The IRR would empower the Bank of England (acting in its role as Resolution Authority) to restructure, modify, limit or write down the unsecured liabilities of a failing insurer, in exchange for shares in such insurer. This could result in writing down liabilities to policyholders, but with the plan being for the Financial Services Compensation Scheme to provide "top-up payments" so that coverage continues without net reductions. How this would work in practice is untested and the timescales involved unclear.

However, careful consideration should be given where there is intention to move to buy out with the insurer. The expectation is that once the insurer is in resolution, its permission to write new business may be limited or removed. This is a potential risk that could impact plans to transition to buy out.

The expectation is that the most likely use of a bail-in would be either to facilitate a run-off of all business, or as a tool used in combination with other stabilisation options. To the extent there is simply a run-off of all business, trustees would need to consider ascertaining whether transition to a buy-out would still be possible with the struggling insurer, at least where additional cover is required. Trustees would also need to examine any termination options with a view to recovering all or some of the value of the buy-in contract – see further discussion below.

Restriction on policyholder surrender rights

HM Treasury is concerned that a failing insurer might find itself having to deal with several policyholders all wanting to terminate their policies early in exchange for the cash value. When it is already under stress, having to fund these payments could place "liquidity and/or capital strain on the insurer". Under the IRR it is proposed that the Bank of England would have the power to temporarily restrict these early termination rights. This would not happen automatically but would be an extra tool the Bank of England would have available to use at its discretion, whilst consulting with the Financial Conduct Authority at the time to determine how long the restriction would apply for.

How this would apply to buy-in/buy-out transactions remains to be tested. In the limited circumstances where any termination rights have been negotiated in the buy-in contract, trustees will need to be aware that any restriction on surrender rights may prevent the use of any such rights during a temporary stay period.

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When would these powers apply?

Resolution conditions:

1. The Prudential Regulation Authority needs to have assessed that an insurer is "failing or likely to fail".

   If this first "resolution condition" is met there are then the following other resolution conditions that need to be met consecutively in order to place an insurer into resolution.

2. The Bank of England assesses that, having regard to timing and other relevant circumstances, it is not reasonably likely that action will be taken by or in respect of the insurer that will result in the first condition ceasing to be met.

3. The Bank of England assesses that the exercise of the stabilisation powers is necessary having regard to the public interest in the advancement of one or more of the statutory resolution objectives.

4. The Bank of England assesses that one or more of the statutory resolution objectives would not be met to the same extent if stabilisation powers were not used.

How likely is resolution to apply to any given insurer?

The expectation is that the majority of insurers would not likely be systemically important enough to meet the tests for resolution action and would be put into another procedure (eg administration or liquidation) at the point of failure. Consequently, the proposed powers described here are unlikely to apply in most situations. However, the Government expects that "niche insurers" offering specific products to significant shares of the UK market will be in scope of the proposed regime. Therefore, it remains to be seen whether insurers offering buy-in products could potentially be in scope, even if they are a relatively small in size.

When will the IRR come into effect?

It is unclear when the IRR may come into effect. The previous Conservative Government stated in August 2023 that it "plans to legislate when Parliamentary time allows and will set out further information on plans in due course". The intention was that, once any legislation is passed, the stabilisation options and related powers would be made available to the Bank of England as soon as practicable, with the industry "given sufficient time and notice to make any necessary changes to accommodate these new powers". Indications are that a minimum 12-month lead-in time is likely to be necessary for firms to implement any planning required.

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