

# INSURANCE DAY



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## Arguing the case for the extension of the UK FSCS

Like several countries, the UK has a guarantee scheme – the Financial Services Compensation Scheme (FSCS) – which protects policyholders if their insurer becomes insolvent, report Philip Woolfson, partner in the Brussels office, and Angus Rodger, partner in the London office, of Steptoe & Johnson.

### Two-tier test for the FSCS

The Financial Services and Markets Act 2000 uses a two-tier test to identify whether the scheme applies to:

- i) The place where the risk is situated; and
- ii) The place where the insurance contract is issued.

If the risk is situated in an European Economic Area (EEA) state other than the UK, then the policy is not covered by the FSCS unless it is “issued ... through an establishment in the UK”. This means that if the branch of a UK insurer issues a policy in another EEA state to a policyholder residing in that state, the policyholder will not be protected by the FSCS.

This gap has already provoked criticism. For example, last June the European Parliament’s report on Equitable Life stated that “non-UK

Equitable Life members are clearly in an unfavourable position”.

Last week, the UK Financial Services Authority invited the insurance industry to comment on whether the FSCS should either be expanded (to bring policyholders in other EEA states within the scheme) or reduced (to exclude UK policyholders who buy policies from EEA branches).

There are several arguments in favour of expanding the scheme.

First, UK insurers, including their EEA branches, are subject to UK solvency and other prudential requirements. If a UK insurer becomes insolvent, policyholders resident in the UK would be covered by the FSCS, whereas policyholders resident in other EEA member states with locally issued policies would not be covered. This appears to be unjustified and unfair, as well as having a whiff of discrimination about it.

Second, certain other EEA member states have guarantee schemes which are not open to the local branches of UK insurers. Branches of UK insurers which issue policies in those jurisdictions are therefore at a competitive

disadvantage against the local insurers, because they do not offer the same degree of insolvency protection.

Third, brokers in such jurisdictions take account of membership of an insolvency scheme when advising clients on their choice of policy. The broker, fearful of incurring liability pursuant to the Insurance Mediation Directive, may be reluctant to recommend a product which is not covered by an insolvency scheme.

Fourth, the branch may find the ratings of its local policies impaired by the fact they are not covered by a guarantee scheme.

Lastly, Solvency II recognises the risk of insurer failure, which highlights the need for adequate guarantee schemes.

### Extension of UK scheme desirable

For insurers with EEA branches, an extension of the UK guarantee scheme seems desirable. If not, in the event of an insolvency, policyholders in the EEA with locally issued policies will inevitably ask why their interests were not protected.

The Association of British Insurers has invited comments by October 16.