

# **FINANCIAL SERVICES AND MARKETS ACT 2000**

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## **EXPLANATORY NOTES**

### **COMMENTARY ON SECTIONS**

#### **Part Xv: the Financial Services Compensation Scheme**

420. This Part of the Act provides for a single Financial Services Compensation Scheme, established by the Authority and managed by an independent scheme manager. It gives the Authority powers to specify the regulated activities covered by the scheme.
421. The purpose of the compensation scheme is to compensate customers who suffer loss in various circumstances as a consequence of the inability of an authorised person to meet its liabilities. The scheme is not, other than in cases of the insolvency of an authorised person, intended to provide compensation for a regulatory breach (for example the mis-selling of investments), where the liability would remain with the authorised firm.

#### ***Section 212: The scheme manager***

422. This section requires the Authority to establish a company to manage the scheme and sets requirements as to the company's constitution, including that the chairman should be appointed by the Authority with the approval of the Treasury and that board members should act independently of the Authority.

#### ***Section 213: The compensation scheme***

423. This section imposes certain requirements about the Authority's rules establishing the scheme. It also makes it clear that customers may be eligible to make a claim against an authorised person even if the claim arises in relation to an activity for which that authorised person did not have permission. A claim relating to an appointed representative who is an exempt person by virtue of section 39 may also qualify under the scheme. Claims would not, however, be eligible if they related to regulated activities carried on by a person who should be authorised but is not.
424. *Subsection (3)(b)* provides for the scheme manager to levy authorised persons to cover both the costs of compensation and its administrative costs.
425. *Subsection (5)* requires the scheme manager when setting the levy to seek, so far as is practicable, to avoid cross-subsidy between sectors.
426. *Subsection (10)* allows the Treasury to prescribe categories of persons authorised to carry on regulated activities in the United Kingdom under passporting arrangements that will only participate in the scheme if they elect to do so. This allows the Treasury to ensure that, while membership of the scheme is generally compulsory for authorised persons carrying on relevant activities, it remains compatible with UK obligations under EC directives which make rules about the extent to which EEA firms can be required to join compensation schemes other than their home State scheme.

***Section 214: General***

427. This section clarifies the scope of the Authority's power to make scheme rules.
428. *Subsection (1)* provides, in particular, that the scheme may consist of a number of different compensation funds, for which levies can be raised from different sectors of the industry and different rules may be made as to the level of and eligibility for compensation.
429. *Subsections (2) to (4)* enable the scheme to limit the eligibility of claimants according to a number of different factors, including where the event took place or where the claimant resides.
430. *Subsection (6)* confers on the scheme manager a power to enter into arrangements with schemes established in other countries outside the EEA. Where, for example, a US firm does business in the United Kingdom and the level of compensation under the US scheme is lower than in the United Kingdom, the firm would be able to become a member of the UK scheme for the purposes of topping-up its cover. If the firm was unable to meet its liabilities, claimants might have a claim against both the US and the UK schemes. This power would in turn enable the UK scheme to enter into an arrangement with the US scheme to avoid the need for the claimant to submit a claim to both schemes. It is possible to make reciprocal arrangements under the power in *subsection (1)(k)*.

***Section 215: Rights of the scheme in relevant person's insolvency***

431. *Subsection (1)* enables the Authority to make provision about the effect of a payment of compensation under the scheme on the rights and obligations arising out of the claim against a relevant person in respect of which the payment was made. This allows the Authority to make provision for the rights of the claimant to be transferred to the scheme manager, which would enable the scheme manager to seek to recoup the costs of paying compensation from the firm in question without increasing the firm's liabilities. *Subsection (2)* provides that any right of recovery conferred on the scheme manager under *subsection (1)* cannot exceed the claimant's original rights.

***Section 216: Continuity of long-term insurance policies***

432. The special nature of long-term insurance means that should an insurer go into liquidation, a simple payment of compensation may not necessarily be enough to enable policyholders to find alternative cover. This would be a problem especially where a person had developed health problems since taking out the original policy. The purpose of this section is to enable the Authority to include in the scheme rules a requirement for the scheme manager to seek to transfer the business of a failing insurer, so far as it relates to contracts of long-term insurance, to another company or to secure the issue of substitute policies by another insurer.

***Section 217: Insurers in financial difficulties***

433. The special features of long-term (or "life") business are noted above. But even general insurance business (for example car or product liability insurance) can result in claims arising from events which may have happened several years earlier. This long tail of claims means that it can be difficult to crystallise the liabilities of an insurer in liquidation. The administration of insurance claims is costly and the delays for policyholders can be substantial while a liquidator seeks to work out the level of payments that can be made to creditors.
434. Accordingly, this section allows the Authority to make provision for the scheme manager to give assistance to an authorised person with permission to effect and carry out contracts of insurance in financial difficulties, either by transferring the that person's business, so far as it relates to contracts of insurance, to another insurer, or by enabling

the continuance of that business by another insurer. Before using this power, which is potentially of substantial benefit to policyholders, the scheme manager must be satisfied that payments to the firm should not materially benefit other persons such as shareholders or company directors. It must also be satisfied that these measures would not cost more than the costs of compensation if the firm were allowed to go into default.

***Section 219: Scheme manager's power to require information***

435. The efficient settlement of claims will sometimes require the scheme to obtain information from a variety of sources. This section provides the scheme manager with powers to require the provision of specified information that it considers necessary in order to be able to assess claims. Information may be required from the authorised person, or from a person who was knowingly involved in the events giving rise to the claim.

***Section 220: Scheme manager's power to inspect information held by liquidator etc***

436. This section allows the scheme manager to inspect information held by the liquidator, administrator or trustee in bankruptcy of an insolvent relevant person. The scheme manager is only allowed to inspect documents rather than require them to be produced, which means that the cost of copying documents will be borne by the scheme and not by the liquidator. This should reduce costs to the liquidator, administrator or trustee in bankruptcy. The section does not apply to the Official Receiver or his Scotland and Northern Ireland counterparts (as to which see section 224).

***Section 221: Powers of court where information required***

437. This section provides that, where a person fails to comply with a requirement for information under section 219 or to permit documents to be inspected under section 220, this may be certified to the court, which may deal with the person as though he were in contempt.

***Section 222: Statutory immunity***

438. This section provides immunity for the scheme manager, and its staff from actions for damages, except where they act in bad faith or where damages are sought under section 6(1) of the Human Rights Act 1998.

***Section 223: Management expenses***

439. This section ensures that the scheme may only recover from levies management expenses up to a certain limit. The limit must be set before the scheme includes management expenses in its calculations of the levies.