

# **Mesothelioma compensation: amending the Financial Services Compensation Scheme**

## **A final Regulatory Impact Assessment**

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November 2006



HM TREASURY







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amending the Financial Services  
Compensation Scheme  
A final Regulatory Impact  
Assessment**

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# REGULATORY IMPACT ASSESSMENT

## TITLE OF PROPOSAL

**1.1** Compensation Act 2006 (Contribution for Mesothelioma Claims) Regulations 2006).

**1.2** The proposal is to amend the Financial Services Compensation Scheme (“FSCS”) to enable persons who are liable for having exposed somebody to asbestos as set out in section 3 of the Compensation Act 2006 (“a responsible person”) and/or insurers of such persons to recover a contribution from the FSCS, where a victim or a policyholder would have a claim against the FSCS, other than under the new rules.

## PURPOSE AND INTENDED EFFECT

### Background, objective and rational

**1.3** The Government’s decision to legislate to reverse the effects of the House of Lords’ judgment in *Barker v Corus* (and conjoined cases)<sup>1</sup> through the Compensation Act 2006 means responsible persons (for example employers) will be jointly and severally liable to meet the full amount of any claim arising from negligently exposing an individual to asbestos and that individual developing mesothelioma (an asbestos related cancer of the lining of the lungs or abdomen) as a result.

**1.4** This will mean that claimants will be seeking compensation from one responsible person, typically medium to large employers or from Government (in relation to state-owned industries). Once liability has been established the responsible person (including its insurer if it has one) will be liable to pay 100% of the compensation. The responsible person (or insurer) can then seek a contribution from other responsible persons.

**1.5** The Financial Services Compensation Scheme (FSCS) provides a consumer safety net in relation to financial services – it is the UK’s statutory fund of last resort for consumers of authorised financial services firms, including persons affected by the default of such firms. The FSCS can pay compensation if a firm is unable, or likely to be unable, to pay valid claims against it. The FSCS is an independent body, set up under the Financial Services and Markets Act 2000 (FSMA). The FSCS insurance sub-scheme broadly covers claims for compensation that arise following the failure of an authorised insurer under the terms of that insurer’s insurance policies. In general, the FSCS will safeguard policyholders if an authorised firm (ie an insurer) is unable to meet claims. The FSCS is funded by levies on authorised firms.

**1.6** At present, the FSCS cannot contribute to all cases which have been settled in full by a third party, for example, another employer or its insurer. The FSCS is a fund of last resort, so that if a claim is already settled, or another party might pay, FSCS cannot provide compensation. This would put responsible persons, including their insurers, at a disadvantage. (The current practice is that the FSCS agrees to make a parallel payment to the claimant in respect of compensation, but this can cause delay whilst the position of any insolvent insurer and the extent of FSCS involvement (if any) is established). Thus if a particular responsible person is found to be liable to the victim for the whole of his damages (by virtue of joint and several liability with other responsible persons), and settles the claim in full, in the absence of these proposed changes, such a responsible

<sup>1</sup> [2006] UKHL 20

person or his insurer would not be able to recover a contribution in respect of an insolvent insurer funded by the FSCS.

**1.7** HM Treasury and the FSA are therefore proposing an amendment to the FSCS that would put responsible persons and/or their insurers in the position to ensure that they can claim a contribution from the FSCS where another relevant insurer is insolvent. The changes to compensation arrangements should speed up payments of compensation to victims of mesothelioma by allowing responsible persons or their insurers to make swift and full payments to the victim. It will also allow them subsequently to recover any appropriate contributions from other responsible persons or their insurers (and therefore if the insurer is insolvent, the FSCS). This should ensure i) that there is no delay in compensation being paid to claimants while the FSCS' liability is being established and ii) insurers/responsible persons are paying the same compensation as they would have done prior to the Barker judgment.

**1.8** A power was included in the Compensation Act 2006 allowing HM Treasury to make regulations about the provision of compensation via the FSCS to a responsible person<sup>2</sup> (eg the employer) or an insurer of a responsible person in specified circumstances.

**1.9** Although many of the required changes could have been made through FSA rules, this additional power was necessary to allow various technical changes to be made including how the FSCS deals with claims involving facts relating to before the commencement of FSMA (1 December 2001) (in relation to which parts of the Policyholders Protection Act 1975 are saved by the transitional provisions applying to the FSCS).

**1.10** The powers included in the Compensation Act 2006 are strictly limited to mesothelioma claims as defined in the Act. The regulations would require affirmative resolutions by both Houses of Parliament for them to come into effect.

## CONSULTATION

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**1.11** This RIA concerns amending the FSCS via Statutory Instrument and FSA rules to facilitate the payment of compensation claims to sufferers of mesothelioma by those responsible for having exposed the sufferers to asbestos as set out in section 3 of the Compensation Act 2006. It is not, however, an assessment of the changes made in the Compensation Act itself or the decision to reverse the effects of the Barker judgment.

**1.12** A consultation seeking views on the proposed changes was launched on 8 September and closed on 6 October 2006. Given the urgency with which the changes need to be made, so claimants, responsible persons and insurers have certainty as to how mesothelioma claims were to be dealt with, Ministers decided to limit the consultation period to 4 weeks. In light of this shortened consultation period, a stakeholder event was held on 22 September to explain the proposals to practitioners. 14 responses were received to the consultation from insurers, employers, law firms acting for mesothelioma sufferers' interests and trade bodies. A summary of responses to the consultation is available on HM Treasury's website ([www.hm-treasury.gov.uk](http://www.hm-treasury.gov.uk)).

**1.13** This RIA sets out the implementation options and considers the qualitative, and where possible, quantitative costs and benefits. Risks, unintended consequences and

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<sup>2</sup> "Responsible person" is defined in the Compensation Act 2006 (see Part 1, 3(1)(a) and 3(10)(a)).

any compliance and enforcement issues have also been incorporated as costs and benefits. Competition issues and the impact on small firms have also been considered

## OPTIONS

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### Option 1

**Do nothing** 1.14 As with all proposals for legislation, HM Treasury has considered the option of making no changes. This would mean that if a particular person is found to be liable to the victim for the whole of his damages (by virtue of joint and several liability with other responsible persons), and settles the claim in full, such a responsible person or his insurer would not be able to recover a contribution funded by the FSCS. To make no change would disadvantage responsible persons and insurers as a result of the changes in the Compensation Act 2006, and could delay compensation to victims of mesothelioma.

### Option 2

1.15 HM Treasury and the FSA are therefore proposing an amendment to the FSCS that would put responsible persons and/or their insurers in the position to ensure that they can recover a contribution from the FSCS.

**HM Treasury's SI** 1.16 HM Treasury's Statutory Instrument will make amendments to the FSCS Order<sup>3</sup> and also provides further power for the FSA to make rules in relation to mesothelioma claims. The FSCS Order sets out provisions which allow claims for compensation to be made against the scheme manager of the Financial Services Compensation Scheme which relate to the period prior to the coming into force of FSMA on 1 December 2001. HM Treasury's Statutory Instrument will enable the FSA, which is responsible for making the rules of the FSCS, to modify the FSCS to enable a person who is liable in tort (or his insurer) for having exposed a person to asbestos to recover a contribution from the FSCS in the circumstances described below. The regulations set out the circumstances where a contribution can be paid to such persons by the FSCS.

1.17 Presently many mesothelioma claims which relate to the period before 1972, when employers were not obliged to have employers' liability insurance, are dealt with under transitional provisions to the FSCS scheme, rather than under the current FSCS scheme itself. These claims rely on the provisions of the Policyholders' Protection Act 1975 (the "PPA"), which are saved by the FSCS Order. The combination of the FSCS rules, FSCS Order and the saved provisions of the PPA makes for a complex set of rules to interpret even for professionals. One way of achieving the policy aim would be to amend the PPA, but this would be technically complicated and not very transparent. The approach, therefore, is to apply the new FSCS scheme to all mesothelioma claims, subject to not expanding the liability of the scheme, achieved by tying liability back to what a victim or in some cases a responsible person could have expected to be paid under the old rules or, if appropriate, under the post FSMA FSCS rules.

1.18 The FSA's rules will govern the detailed working of the scheme. HM Treasury's Statutory Instrument gives the FSA further power to make specific rules relating to mesothelioma claims, which are subject to two conditions. The conditions are that:

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<sup>3</sup> Financial Services and Markets Act 2000 (Transitional Provisions, Repeals and Savings) (Financial Services Compensation Scheme) Order 2001, SI 2001/2967 ("the FSCS Order")

- claims of responsible persons or their insurers can be entertained only where the victim or a responsible person could have claimed on the FSCS under the FSCS transitional order or under the post FSMA FSCS rules; and
- the responsible person or their insurer is claiming a contribution from another responsible person, but is unable to get it because the insurer of the other responsible person is unable or likely to be unable to pay.

**1.19** In addition, the draft Statutory Instrument allows the payment of compensation to a responsible person or their insurer notwithstanding that they have already made a payment to the victim. The Statutory Instrument applies to applications for payment made on or after 25 July 2006. It should be noted that the provisions in the Statutory Instrument are tied into section 3(1) of the Compensation Act. If medical science advances so that it becomes possible to determine with certainty whether a specific exposure caused the disease then claims will no longer be possible under this instrument or the Act itself.

**FSA rules 1.20** The FSA rules covering compensation are in the COMP Sourcebook of the FSA Handbook. COMP sets out the rules governing the Financial Services Compensation Scheme (FSCS) and the circumstances in which compensation may be paid and to whom compensation may be paid.

**1.21** The FSA will amend the FSCS rules so the FSCS can consider mesothelioma claims in line with the policy intention set out during consideration of the Compensation Act 2006. As explained above, HM Treasury's proposed Statutory Instrument gives the FSA the power to make rules applying to circumstances where compensation would be payable in relation to mesothelioma claims, including in situations covered by the transitional rules in the FSCS Order.

**1.22** The FSA's rules will result in five material amendments to the Compensation Sourcebook (COMP) of the FSA's Handbook. They will enable the FSCS to make payments to a responsible person or their insurer notwithstanding that they have already made a payment to the victim. This would avoid delay of the current parallel payment approach (described above) in compensation being paid to claimants until the FSCS' involvement is established. The rules apply to applications for payment made on or after 25 July 2006 and will be made under the powers given in the draft Statutory Instrument.

**1.23** The effect of the amendments is that all claims for a contribution in relation to mesothelioma claims will now be dealt with under the FSCS, whether the claim to which it relates was dealt with under the FSCS Order or the FSCS itself.

## COSTS AND BENEFITS

**Groups affected 1.24** The following main groups have been identified as potentially being affected by these proposals<sup>4</sup>:

- mesothelioma sufferers and their families, needing quick access to compensation;
- responsible persons having asbestos liabilities and their liability insurers, who, following these proposed changes, will be able to claim a contribution

<sup>4</sup> It has not been possible to identify the numbers in each affected group because until each new mesothelioma case arises there is no way of predicting who the responsible person(s) will be. This has constrained the ability to assess the overall benefits and costs of the proposed changes to compensation arrangements.

from the FSCS where the exposed person has developed mesothelioma and where presently a victim of the disease or in certain cases a responsible person could recover compensation from the scheme; and

- other insurers may also be affected through changes in the timing of levy payments if claims are paid earlier than under current provisions.

**Benefits 1.25** The changes to compensation arrangements should speed up payments of compensation to victims of mesothelioma by allowing responsible persons or their insurers to make swift and full payments to the victim. It will also allow them subsequently to recover any appropriate contributions from other responsible persons or their insurers (and therefore if the insurer is insolvent, the FSCS). This should ensure i) that there is no delay in compensation being paid to claimants while the FSCS' liability is being established and ii) insurers/responsible persons are paying the same compensation as they would have done prior to the Barker judgment.

**1.26** Mesothelioma used to be a rare cancer, but there are now over 1800 cases a year. However, the long latency means that despite far better controls on the use of asbestos in recent years the rate is still rising as a result of earlier exposures. Although predictions are uncertain and highly sensitive to assumptions, cases could reach 2400 deaths per year by 2013 then fall away to perhaps 500 cases per year by 2050. Because cases are complicated and it is difficult to establish liability there is often a delay in making payments. The changes in liability brought about through the Compensation Act 2006 coupled with the changes to the operation of the FSCS should facilitate the quicker payment of compensation potentially benefiting a large number of individuals who may contract the disease in the future. Total compensation awards follow guidelines and traditional "heads of damages", and typically range from £75,000 to £150,000 depending on circumstances, though some are higher.

**Costs 1.27** The changes to the FSCS rules included in this document will not change the underlying eligibility rules, the limit of compensation for mesothelioma claims, or the scope of the FSCS. As the resulting rule changes will not alter the total liability of the FSCS or the maximum amount of compensation that can be paid, the total possible cost to the insurance industry levy payers will be the same.

**1.28** However, if claims are paid more quickly by the FSCS, which is the policy intention, then the cost to levy payers will also arise more quickly as a result. Given the projections set out in paragraph 1.26 above, the shift in levy from future time periods to the present should imply that the cost impact may be felt more heavily by the insurance industry in the next few years. In addition, because it will now be easier for responsible persons or their insurers to share the costs with the FSCS, more claims may potentially be made.

**Other potential implications 1.29** One respondent noted that the option of pay and reclaim (ie seeking a contribution from the FSCS after full compensation has been paid to the victim) could put a financial strain on companies in run-off (since they have a limited pool of resources from which to pay claims and no potential for raising additional capital) and the responsiveness of the FSCS in dealing with requests for contributions will be important. Comments were received from one respondent that there may, in future, be a tendency for victims and their advisors to concentrate claims on a few large companies/insurers, which, it was argued, could lead to a reduced pool of responsible persons and insurers to pay damages. Any such effects would be consequences of the decision to reverse the effects of the Barker judgment in the Compensation Act 2006, but in practical terms the Act simply returned the position to what it was pre-

Barker (less than three months before the Act was passed). The changes made to the FSCS have no bearing on these points since the changes simply facilitate rather than impose a pay and reclaim process.

**1.30** It should be noted that the FSA have published a discussion paper (DP06/1 'FSCS Funding Review' March 2006) on reviewing the funding of the FSCS and a consultation paper will follow. The proposed changes may impact on firms that contribute to the costs of the general insurance block. The Discussion Paper is available on the FSA website at: [www.fsa.gov.uk/pubs/discussion/dp06\\_01.pdf](http://www.fsa.gov.uk/pubs/discussion/dp06_01.pdf).

### **SMALL FIRMS IMPACT TEST**

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**1.31** It is highly unlikely that these proposals in themselves will have a disproportionate impact on smaller firms. However, the ongoing review of FSCS funding, mentioned above, may impact on firms that contribute to claims relating to general insurance within the FSCS.

### **COMPETITION ASSESSMENT**

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**1.32** This change to the FSCS is unlikely to have any competition impacts.

### **ENFORCEMENT, SANCTIONS AND MONITORING**

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**1.33** The FSCS will implement changes to the scheme following the changes to FSA rules and will keep operation of the rules under review.

### **IMPLEMENTATION AND DELIVERY PLAN**

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**1.34** HM Treasury will take forward laying the Statutory Instrument which is subject to the affirmative resolution procedure. Given the changes need to be made quickly to i) ensure victims of mesothelioma receive quick access to compensation and ii) responsible persons and their insurers can seek recovery of contributions from the FSCS, the FSA rules will come into effect shortly after HM Treasury's Statutory Instrument takes effect.

### **POST-IMPLEMENTATION REVIEW**

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**1.35** The FSCS will keep the operation of the rules under review and will report any problems with the rules to HM Treasury and FSA. As noted in paragraph 1.19 above, there is an automatic sunset clause in the Compensation Act 2006 which the powers granted by the Statutory Instrument are tied into.

### **SUMMARY AND RECOMMENDATION**

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**1.36** The Treasury and FSA have decided to amend the Financial Services Compensation Scheme to enable persons who are liable for having exposed somebody to asbestos as set out in section 3 of the Compensation Act 2006 ("a responsible person") and/or insurers of such persons to recover a contribution from the FSCS, where a victim or a policyholder would have a claim against the FSCS, other than under the new rules.

**1.37** The changes to compensation arrangements should speed up payments of compensation to victims of mesothelioma by allowing responsible persons or their insurers to make swift and full payments to the victim.

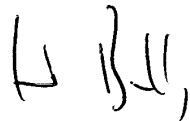
**1.38** The changes to the FSCS rules included in this document will not change the underlying eligibility rules, the limit of compensation for mesothelioma claims, or the scope of the FSCS. As the resulting rule changes will not alter the total liability of the FSCS or the maximum amount of compensation that can be paid, the total possible cost to the insurance industry levy payers will be the same.

**1.39** The option of doing nothing was considered, but, in light of the legislative changes made in the Compensation Act 2006, it was judged that this would put responsible persons and insurers in a disadvantaged position.

## MINISTERIAL DECLARATION

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*I have read the Regulatory Impact Assessment and I am satisfied that the benefits justify the costs.*



**ED BALLS MP,  
ECONOMIC SECRETARY TO THE TREASURY**

1 November 2006

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