

**EXPLANATORY MEMORANDUM TO  
THE COMPENSATION ACT 2006 (CONTRIBUTION FOR MESOTHELIOMA  
CLAIMS) REGULATIONS 2006**

**2006 No. 3259**

1. This explanatory memorandum has been prepared by Her Majesty's Treasury and is laid before Parliament by Command of Her Majesty.

This memorandum contains information for the Joint Committee on Statutory Instruments.

2. **Description**

2.1 The Compensation Act 2006 (Contribution For Mesothelioma Claims) Regulations 2006 amend the Financial Services and Markets Act 2000 (Transitional Provisions, Repeals and Savings)(Financial Services Compensation Scheme) Order 2001, S.I. 2001/2967 ("the Transitional Order") and provides the Financial Services Authority ("FSA") with an additional power to make rules for the Financial Services Compensation Scheme ("FSCS").

3. **Matters of special interest to the Joint Committee on Statutory Instruments**

3.1 None.

4. **Legislative Background**

4.1 The Financial Services Compensation Scheme ("FSCS") was established under Part XV of the Financial Services and Markets Act 2000 ("FSMA"). The FSCS deals with claims in relation to authorised persons under FSMA and those treated as authorised persons<sup>1</sup>. The Transitional Order makes transitional provisions in relation to eight former compensation schemes and provides for the FSCS to pay transitional claims in relation to financial services' providers which arise out of facts which took place before 1 December 2001. To some of these cases the FSCS applies and to others saved provisions of previously applicable compensation legislation apply, for example, provisions of the Policyholders Protection Act 1975.

4.2 Given the long latency period of mesothelioma the position in relation to the period prior to the current financial services compensation arrangements which were brought into effect by FSMA is important as some claims will need to be brought under the transitional provisions to the current compensation arrangements.

4.3 The Financial Services Authority ("FSA") makes the rules and gives guidance in relation to the FSCS. This instrument provides a power for the FSA to modify the FSCS, in relation to the claims referred to above, in order to make payments to a responsible person defined in section 3 of the Compensation Act 2006, that is a person

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<sup>1</sup> See in relation to insurers article 14 of Financial Services and Markets Act 2000 (Transitional Provisions) (Authorised Persons etc.) Order 2001, S.I. 2001/2636.

who is liable for having negligently or in breach of statutory duty exposed another to asbestos who has gone on to develop the disease and/or insurers of such a person.

4.4 This power (set out in Regulation 2) which is inserted as new article 9A into the Transitional Order permits the FSA to make rules modifying the new scheme (i.e. the FSCS) and to give guidance on the scheme, rather than taking the approach of amending the saved provisions under the Transitional Order<sup>2</sup>. The latter approach would have been possible but the approach taken should provide a clearer legislative path for users to follow. This power applies in relation to insurers authorised at any time under the Insurance Companies Act 1982.

4.5 An additional power in very similar terms to new article 9A (set out in Regulation 3) is provided for the FSA to make rules for the FSCS in relation to insurers who are or have been authorised (or treated as authorised) under FSMA.

4.6 These regulations are the first regulations to be made under a new power set out in section 3 of the Compensation Act 2006 (c. 29) (the “Act”). The scope of the power is set out in section 3(7) of the Act (which is further particularised in 3(8)) and 3(11). The conditions in section 3(7) are reflected in the conditions in new article 9A(2) of the Transitional Order and Regulation 3(2)(b) of the instrument. The temporal scope of section 3 of the Act, which has retrospective affect, is set out in section 16(3) to (6) of the Act. The regulations refer to applications for compensation made on or after the date of passing of the Act (25 July 2006), which by virtue of section 16(5) and (6) can apply to claims which are settled or to which legal proceedings are determined on or after 3 May 2006.

4.6 Given the importance Ministers attach to the issue of compensation for mesothelioma sufferers and the need for these changes to be made quickly, the Treasury disapplies in relation to the first use of the new powers granted to the FSA and in relation to mesothelioma claims, the consultation provisions in relation to FSA rules and guidance contained in FSMA.

## **5. Extent**

5.1 This instrument applies to all of the United Kingdom.

5.2 Section 3 of the Compensation Act 2006 applies to the UK by virtue of section 17(2) of that Act. Part XV of FSMA also applies to the UK by virtue of section 430 of FSMA.

## **6. European Convention on Human Rights**

The Economic Secretary to the Treasury has made the following statement regarding Human Rights:

In my view the provisions of the Compensation Act 2006 (Compensation for Mesothelioma) Regulations 2006 are compatible with the Convention rights.

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<sup>2</sup> In relation to insurance, the Policyholders’ Protection Act 1975 is saved, modifications to that Act are set out in the Schedule 1 to the Transitional Order.

## **7. Policy background**

7.1 Mesothelioma is a cancer of the lining of the lungs or abdomen, which is almost always caused by exposure to asbestos. A recent House of Lords case (*Barker v Corus*) decided that that liability for damages was to be apportioned among those responsible for the wrongful exposure according to the relative degree of contribution to the chance of the person contracting the disease. This meant that claimants would have to trace all relevant defendants before liability could be apportioned and full compensation paid, or alternatively to issue multiple claims to recover damages on a piecemeal basis. The practical effects of this decision were that claims could take much longer to be concluded, and would be much more difficult and time-consuming for claimants in circumstances where they and their families were already under considerable stress. Given this, the Government decided to reverse the effects of the Barker judgement to enable victims, or their estate or dependants, to claim full compensation from any persons liable in negligence or in breach of statutory duty for having exposed them to asbestos. It will then be open to the person who has paid the compensation to seek a contribution from other negligent persons. This was achieved through the Compensation Act 2006.

7.2 As a result of this change, certain changes are necessary to the FSCS. The FSCS provides a consumer safety net in relation to financial services – it is the UK's statutory fund of last resort for consumers<sup>3</sup> of authorised financial services firms. The FSCS can pay compensation if a firm is unable, or likely to be unable, to satisfy claims against it. The FSCS is an independent body, set up under section 213 of FSMA.

7.3 At present, the FSCS cannot contribute to all cases which have been settled in full by a third party. This would prejudice responsible persons (referred to in paragraph 4.3) since they would not normally be able to make claims against the FSCS. In practice the consequence has been and would be delay in paying compensation in order first to establish the liability of all parties so as to set up a process of 'parallel payment', (i.e. a responsible person and FSCS (in place of the insolvent insurer) pay the claimant at the same time). The proposed changes to the compensation rules would allow responsible persons to change to a 'pay and be paid' approach, whereby a responsible person may pay the claim first and recover at a later date the payment that the FSCS would make.

7.4 Such recovery would be available only where (i) presently a victim of the disease (or in some cases a responsible person) could recover compensation from the scheme and (ii) the responsible person 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. These changes should avoid delay in compensation being paid to claimants until the FSCS involvement is established.

## **8. Impact**

8.1 A Regulatory Impact Assessment is attached to this memorandum.

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<sup>3</sup> The term "consumers" is defined widely in section 138(7) of FSMA and includes "persons ... who have rights or interests which are derived from or are otherwise attributable to the use of any such services by other persons ...".

8.2 The proposals will have an impact on the public sector in that, where Government Departments or previously nationalised industries are responsible persons they will be able to claim a contribution from the FSCS if the criteria set out above are met.

## **9. Contact**

Darren Philp at Her Majesty's Treasury Tel: 020-7270 5468 or e-mail: [darren.philp@hm-treasury.gsi.gov.uk](mailto:darren.philp@hm-treasury.gsi.gov.uk) can answer any queries regarding the instrument.

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## REGULATORY IMPACT ASSESSMENT

### TITLE OF PROPOSAL

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**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

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#### 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 person or his

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

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 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

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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)).

## 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** **1.16** HM Treasury's Statutory Instrument will make amendments to the FSCS Order<sup>3</sup> **SI** 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:

- 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

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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")

- 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**

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**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 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.

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<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.

## 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 **1.35** ensure victims of mesothelioma receive quick access to compensation and **1.36** 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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**1.37** 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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**1.38** 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.

**1.39** 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.

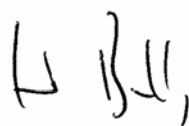
**1.40** The changes to the FSCS rules included in this document will not change the underlying eligibility rules, the limit of compensation for mesothelioma claims, or the scope of the FSCS. As the resulting rule changes will not alter the total liability of the FSCS or the maximum amount of compensation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

**1.41** 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

## **CONTACT POINT**

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