Financial Conduct Authority

Regulator Assessment: Qualifying Regulatory Provisions

Title of proposal: Thematic review of general insurance intermediaries' professional indemnity insurance

Lead regulator: FCA

Date of assessment: 5 December 2016

Commencement date: January 2016

Origin: Domestic

Does this include implementation of a Cutting Red Tape review? No

Which areas of the UK will be affected? Whole of UK

Brief outline of proposed new or amended regulatory activity

The primary purpose of the thematic review was to assess the extent to which a sample of 186 firms' professional indemnity insurance (PII) policies complied with the existing requirements in the FCA Handbook (in MIPRU 3). A secondary objective was to form a view on how well the GI PII market was functioning.

There are three areas where the requirements on firms, as set out in the thematic report, constituted guidance by providing clarification on existing rules. These areas are: minimum policy limits; financial sub-limits for Financial Ombudsmen Service (FOS) awards and suitability of Insurers exclusion. Details of these and the extent to which they will entail costs for firms are provided below.

Which type of business will be affected? How many are estimated to be affected?

The firms primarily affected will be general insurance intermediaries of which 5209 are authorised by the FCA. Insurers and managing general agents (MGAs – intermediaries which function as underwriters) that provide professional indemnity insurance, of which there are around 40, will also be affected.

Price base year	Implementation date	Duration of policy (years)	Business Net Present Value	Net cost to business (EANDCB)	BIT score
2016	2016	10	-1.4	0.2	1.0

The BIT score is the net cost to business for five years.

Please set out the impact to business clearly with a breakdown of costs and benefits

Note – for all cost estimates below we have assumed the changes will be applied by experienced compliance staff at an estimated rate of £48/hour. The 2016 Robert Half salary guide estimates that a compliance manager in the risk and compliance function of a financial services company based in London earns between £70,000 and £104,000 per annum. Based on working 8 hours per day for 260 days each year our rate equates to £100,000 per annum and is therefore considered a suitably prudent figure for the purposes of our estimates.

<u>Familiarisation costs</u>

The report is 5700 words long which, at a reading speed of 100 words a minute, would take 1 hour to read. For intermediaries it is fair to assume they would take another hour to compare the findings and recommendations in the report to their own policy. Therefore we estimate the total costs for intermediaries would be 5,209 firms x £96 = £500k.
Product providers (insurers and MGAs) will also incur costs in familiarising themselves with the report and assessing its implications for them. This will be a more complex process than for intermediaries and is likely to involve three people within each firm, who will then need to discuss any issues for them.[**] On the assumption that this will take in total about 10 hours per firms the total cost will be 40 firms x £480 = £19k.
Total familiarisation costs = £519k (£500k + £19k)

<u>Remediation costs</u>

The findings of the review, except in the three areas set out below, did not go beyond assessing firms PII policies against MIPRU and reporting on that. As compliance with existing regulatory requirements is assumed as part of the Enterprise Act, any costs incurred by firms to bring themselves to compliant standard are not included.

<u>1. Minimum policy limits</u>

The review highlighted that MIPRU 3.2.7 (2) was ambiguous. This stipulates the minimum limit of indemnity a firm must have. It reads*: in aggregate Euros 1,680,300 or, if higher, 10% of annual income up to £30 million*. A number of firms had interpreted that to mean £30m of income rather than £30m of PII cover. We used the report to clarify this point. We required the firms in the review which had inadequate levels of cover to buy more so that they complied with the 10% of income requirement.

The firms which had inadequate cover were all firms which had over £100m of revenue, but were not Lloyd's brokers. (The Lloyd's brokers in the review were all found to buy high limits of cover.) There were five of these type of firm in the review, of these three (60%) had inadequate levels of cover.

In buying extra cover all three of these firms bought more additional cover than strictly required to be compliant with MIPRU. If the additional premiums are pro-rated to levels only consistent with firms buying the minimum required by MIPRU the additional premiums would be: £1.12k (Firm 1); £27.3k (Firm 2); £6.5k (Firm 3). Therefore the mean additional premium paid to buy a compliant level of cover was £11.6k.

There are another eight intermediaries which have revenue in excess of £100m, and are not Lloyd's brokers, but we do not have details of the level of their PII cover. If one assumes that the same proportion of firms as in our sample (60%) did not have compliant levels of cover, then we estimate that an additional 5 firms would need to purchase additional cover. Therefore a reasonable assumption is that they would pay, on average, the same additional premium as the three firms in our sample. The total additional cost would therefore be 8 X £11.6k = £93k per year (total on-going costs)

<u>2. Financial sub-limits in regard to FOS awards</u>

MIPRU requires firms to have cover for awards made by FOS. We found 31 policies had financial sub-limits – typically £100k for any one claim or £150k in the aggregate – which could operate to limit the amount of cover for FOS awards. In the report we said such financial sub-limits were not consistent with the MIPRU requirement, and in saying this we added to the interpretation of MIPRU. Where we found firms had such financial sub-limits we did not regard this as sufficiently material to require the firms to change them immediately to have these limits removed or amended.
Given that i) many policies contain compliant financial sub-limits and ii) the £100k any one claim sub-limit had probably just not been increased to £150k in line with the maximum the FOS can award (which was increased from £100k for complaints after January 2012), it is reasonable to assume that amending FOS sub-limits to compliant level would not entail firms paying any additional premium.

<u>3. "Suitability of Insurer" exclusion</u>

Policies contained a number of exclusions which gave us cause for concern. However as regards only one of these – Suitability of Insurer – did we say in the report that we did not regard this as a permissible exclusion. In this we were going beyond MIPRU. We required firms in the review whose policies contained this exclusion – 12 firms - to have the clause removed. A sample of 6 out of the 12 firms was approached and they confirmed that their PII insurers did not charge any additional premium to have this exclusion removed. So the cost of this requirement in the report of the thematic review can reasonably be assumed to be nil.

Reprinting of policy documentation

The 18 product providers whose policy documentation currently contains the Suitability of Insurers exclusion or inappropriate FOS sub-limits will need to reprint these documents without these terms. It is estimated that the costs of reprinting will be £2k per firm = £36k in total.

Total one off cost = familiarisation costs + re-reprinting costs = £519k + £36k = £555k.

* "EFTEC (2013), "Evaluating the cost savings to business from revised EA guidance – method paper".

** We arrived at this estimate based on our broader supervisory knowledge of how firms respond to our Thematic reviews and also on supervisory conversations with firms about their procedures relating to this specific issue.

Please provide any additional information (if required) that may assist the RPC to validate the BIT Score.

Link to Robert Half salary centre:

https://www.roberthalf.co.uk/news-insights/salary-centre-2016