



Ministry of  
**JUSTICE**

**Claims Management Regulation**

3.10 Selborne House  
54 Victoria Street  
London SW1E 6QW

T 020 7210 8847

F 020 7210 0613

E [kevin.rousell@justice.gsi.gov.uk](mailto:kevin.rousell@justice.gsi.gov.uk)

[www.claimsregulation.gov.uk](http://www.claimsregulation.gov.uk)

1 August 2007

**CLAIMS MANAGEMENT REGULATION  
PROFESSIONAL INDEMNITY (PI) INSURANCE**

The regulation of claims management services under the Compensation Act 2006 fully commenced on 23 April 2007. It is now an offence to provide regulated claims management services unless authorised, exempt or subject to a waiver.

Part 5 of the Compensation (Claims Management Services) Regulations 2006 sets out the requirement for authorised persons to take out a policy of professional indemnity insurance.

The Department held a consultation on PI insurance that ran from 23 February to 25 May 2007. Please find enclosed the Summary of Responses to the consultation and a report on PI insurance prepared by Andrew Fryer of Willis for the Ministry of Justice.

Conclusions and next steps will be published in the autumn following further consideration of the issues.

Yours sincerely,

Kevin Rousell  
Head of Claims Management Regulation



Ministry of  
**JUSTICE**

# Claims Management Regulation – Professional Indemnity Insurance

**Summary of Responses**

CP(R) 04/07: Part 1 of 2

01/08/2007



Ministry of  
**JUSTICE**

## **Claims Management Regulation**

### Professional Indemnity Insurance

**Summary of responses to a consultation carried out by the Ministry of Justice.**

**This information is also available on the Ministry of Justice website at [www.justice.gov.uk](http://www.justice.gov.uk)**

## Contents

Introduction	2
Background	3
Summary of responses	4
Responses to Specific Questions	7
Conclusion and Next Steps	12
Consultation Co-ordinator contact details	13
The Consultation Criteria	14
Annex A – List of Respondents	15

---

## Introduction

This document is the post-consultation report for the consultation paper, Claims Management Regulation – Professional Indemnity Insurance.

It will cover:

- the background to the report;
- a summary of the responses to the report;
- a detailed response to the specific questions raised in the report; and
- the next steps following this consultation.

Further copies of this report and the consultation paper can be obtained by contacting **Niva Thiruchelvam** at the address below:

**Ministry of Justice  
Claims Management & Private Funding Branch  
Legal Services Regulation & Redress Division  
3.10 Selborne House  
54-60 Victoria Street  
London  
SW1E 6QW**

**Telephone: 020 7210 1325**

**Email: [niva.thiruchelvam@justice.gsi.gov.uk](mailto:niva.thiruchelvam@justice.gsi.gov.uk)**

This report is also available on the Department's website at: [www.justice.gov.uk](http://www.justice.gov.uk)

## Background

The consultation paper 'Claims Management Regulation – Professional Indemnity Insurance' was published on 23 February 2007. It invited comments on the introduction of compulsory Professional Indemnity (PI) insurance for businesses that provide regulated claims management services and included draft Rules.

Under the provisions of the Compensation Act 2006, businesses that provide regulated claims management service, without an exemption or a waiver, must be authorised and comply with rules prescribed by the Regulator. The Act expressly allows the Regulator to make rules in respect of PI insurance.

Respondents to the consultation on the Conduct Rules, published on 6 July 2006, favoured compulsory PI insurance but felt that the requirement should not apply to introducers and should not be introduced immediately as some businesses may have difficulty obtaining cover. The Ministry of Justice took these comments into consideration and consulted on the following proposals:

- (a) Authorised businesses that have contracts with client, whether or not they represent clients, should be required to have PI insurance. The intention is to replicate the Financial Services Authority's requirement in respect of general insurance intermediaries.
- (b) Cover should provide for individual claims up to £650,000 with an aggregate limit of £1 million or 10% of annual turnover, if higher.
- (c) The excess should be not more than the higher of £5,000 or 3.0% of annual turnover.
- (d) The requirements should apply from 1 January 2008.

The Consultation period closed on 25 May 2007. This report summarises the responses and outlines the Ministry of Justice's conclusions on the consultation.

A list of respondents is at Annex A.

## Summary of responses

1. A total of 32 responses to the consultation paper were received. Of these, approximately two thirds of responses were from businesses that provided claims management services. Representatives of the legal and insurance industries also responded to the consultation.
2. Separately, the issue has been discussed with the Regulatory Consultative Group, which comprises representatives from the claims management sector, legal field, insurance industry, and consumer groups as well as other regulators.
3. In analysing the responses, we examined the purpose of PI insurance, its availability, the likely cost and impact to businesses, whether it provides protection to consumers and alternative ways consumers might be protected.
4. Claims management businesses have stated that they have never received a complaint based on negligence. Notably, responses in support of PI insurance only referred to theoretical situations in which PI insurance might be available and useful to consumers.
5. The Association of British Insurers' (ABI) response is particularly important as it considers the value of PI insurance to consumers and the effect it will have on the industry:

“We do not believe that there is a clear-cut case for the introduction of a compulsory professional indemnity insurance requirement for claims management companies. This appears to be an attempt to bring in a layer of costs for these companies without any particular benefit to customers. It is important to remember what professional indemnity insurance does. It protects the wrongdoer against his/her own mistakes, and does not provide benefit directly to the consumer. Furthermore, it is not clear that there are significant risks to customers that would make such insurance a necessity, and we are not in favour of such a policy.

In discussions with its members during the period of this consultation, the ABI has not found any who were involved in, or willing to become involved in, the market for PI for claims management companies. This is not to say that no insurer in the UK will eventually provide such a product, although it is very instructive. From this, one could easily infer that such PI insurance will be difficult to find, and premiums may therefore be high, and restrict the market.

Overall, we oppose the consultation paper’s findings in bringing in a requirement for PI insurance for claims management companies. We believe it may be an attempt to restrict the market by introducing unnecessary burdens where little potential risk exists for serious customer detriment.”

6. There was strong opposition to the introduction of compulsory PI insurance by claims management businesses and the ABI, as it did not provide effective protection to consumers and placed a disproportionate burden on businesses.
7. Many of the responses highlighted the difference in the range of claims management services available, depending on the sector in which the authorised business operated, and argued that this should be taken into consideration when setting requirements for PI insurance as it affected the risk of negligence and malpractice. Providing advice, representing claimants, having contracts with clients and holding client money were felt to be important factors in determining whether a business should have PI insurance.
8. Comments on the level of PI insurance needed varied. Some felt that authorised businesses should obtain a similar level of cover to Solicitors as they offered similar services; it was suggested that it would also create a level playing field and provide adequate protection to clients. Others were concerned that the draft Rules did not take account of the varying risks in the different sectors that authorised businesses operated in, e.g. there is a higher risk and higher amount of compensation recoverable in the personal injury sector than in the financial products and services sector.
9. A financial services claims handler’s response stressed this concern:

“A single level of cover is proposed for all claims management firms regardless of the sphere within which they operate. There is no doubt that, where claims are concerned with injury or accident, the sums involved can be very large indeed; for those handling claims of this type the proposal that cover should provide for individual claims up to £650,000 might well be reasonable. But in the case of those concerned solely with financial products and services, the sums involved are relatively low and it is difficult to see why such a high level of cover should be required. ... While it might be administratively more convenient to propose one level of cover for all claims management firms, the one size fits all approach is unfair. It is my view that the level of cover required by the regulations should reflect both the nature and the size of the business.”
10. The availability and cost of PI insurance was also identified as a significant factor. New entrants to the market may well find it impossible to obtain PI insurance and, for very small risk, even if cover could be obtained the cost might be prohibitive.

11. Many responses felt that it may be appropriate for the requirement to be introduced later than 1 January 2008 as businesses may wish to obtain cover when they renewed other insurance or prove that they have cover when they renewed their application for authorisation to provide regulated claims management services. There was also the suggestion that a later date would benefit businesses that had already planned for the current financial year. One response proposed a six-month period between the publication and implementation of the Rules relating to PI insurance.

12. A claims management business suggested the introduction of a compensation scheme:

“We believe a scheme such as the FSCS where firms pay 1% of their turnover would be more beneficial to the aims of better regulation than using the price of coverage and insurance through the private sector.”

## Responses to Specific Questions

### 1. Is it accepted that those businesses that are only introducers should not be required to have PI insurance?

The majority of responses agreed with this proposal, citing the exemption of small-scale introducers and the minimal involvement of introducers.

However, the Association of Personal Injury Lawyers (APIL) felt that introducers posed a risk as claims might not be referred within the time limit, which is vital in the personal injury field. The risks included the possibility that “witnesses may move away, evidence may be destroyed, and memories may fade” which could result in consumers not being able to obtain redress.

The Solicitors Regulation Authority (SRA) felt that PI insurance should be a requirement if a duty of care existed. It was also suggested that there was confusion regarding the specific role of an introducer. The SRA recommended that if PI insurance is not made compulsory for introducers, then the Regulator should publish specific guidance on the role of an introducer and require introducers to disclose that they do not have PI insurance to consumers.

The Legal Complaints Service (LCS) supported the proposal and suggested that the introduction of a mandatory system of recording payments would enable an effective audit to occur.

Liverpool Law Society felt that the potential to cause detriment to consumers needed to be balanced against the cost of PI insurance to introducers.

---

### 2. Should businesses that represent clients have PI insurance?

Overall, there was a positive response to this question, as businesses that had a direct relationship with claimants would have an obligation to them.

AXA Insurance suggested that businesses providing claims management services were similar to any other business offering advice to members of the public.

Solicitors proposed similar levels of protection to themselves suggesting that representation of a client was similar to the services provided by them.

Liverpool Law Society noted that “if all such businesses are compelled to have PI insurance, a better service would ultimately be provided to the consumer as

the businesses are likely to have to improve procedures and policies in order to be able to obtain the insurance at a reasonable premium.”

The scope of negligence in managing a claim was identified as an important factor. Some claims management businesses in the financial products and services sector raised the difference in the representation in the personal injury and financial products and services sectors and the corresponding potential for liability. There is greater potential to harm a claim or limit the amount of compensation recoverable in the personal injury sector than in the financial products and services sector.

One claims management company said:

“We believe that a firm offering Personal Injury Services, arranging insurance for their clients to cover court costs, arranging loans, advising regarding medical conditions or whether the compensation is sufficient to cover the costs of their disability, is very different from advising clients whether they may have a claim on their endowment policy and whether the compensation offered is compliant with FSA Rules.”

However, APIL noted that few businesses represented claimants in the personal injury field.

Dividing claims management businesses on the basis of those who used an Ombudsman and those who used Courts was suggested, as this would take account of the nature of the representation, the associated risks and the amount of compensation recoverable.

---

### **3. Should businesses that have contracts with clients but do not represent them have PI insurance?**

This proposal was supported on the whole, as PI insurance was thought to be useful if there was a breach of contract. It was also suggested that it might provide consumers with protection and confidence.

The LCS believed that PI insurance should be mandatory for those that accepted payment.

APIL felt that PI insurance would be appropriate in the event that a business fails “to arrange adequate after the event insurance for the client, leaving the client exposed to paying the defendant’s cost if the case fails.”

The SRA suggested that PI insurance should be mandatory if there was a risk of an actionable harm occurring.

Many suggested that the requirement be limited to those who provided services after referral of the claim to a Solicitor. Again, it was felt necessary to distinguish between businesses in different sectors.

There was also the suggestion that the requirement for PI insurance be dependent on the nature of the contract and scope for negligence, as the level of service differed from business to business. Some businesses investigated claims obtained evidence, advised in order to arrange after-the-event (ATE) insurance and offered loan finance and held client money.

Liverpool Law Society shared concerns over the nature of the contract and associated risks but commented:

“This does, however, need to be balanced with the cost and availability of PI insurance to these businesses. An important factor in this regard is likely to be the size of the business and it should be noted that such businesses may experience problems obtaining PI insurance.

The Managing Director of PYV, Ian Broscoe, has commented that some insurance providers will not want to encourage the work of claims management companies by offering them protection as many insurance providers view such businesses as being opportunistic and ‘intent on provoking claims rather than helping the public’. As a result, even if cover is available, there are likely to be high premiums. A legal requirement for PI insurance may therefore result in some smaller businesses being forced out of the market place.”

---

#### **4. What should the minimum levels of indemnity and excess be?**

Many Respondents agreed to the proposal in the consultation document.

Solicitors felt that authorised businesses should be subject to the same level of cover as they dealt with the same claims in the personal injury field and offered similar services.

AXA Insurance suggested:

“If the claims management company is representing the client, there should be a far higher limit of indemnity. In this instance, we believe the limit of indemnity should be at least £1m and possibly as high as £5m. This would put it in line with standard limit of indemnities within other liability insurance products and to help to ensure that there is adequate consumer protection.

Where claims management companies are not representing clients, but there is a contractual relationship a lower limit of indemnity would seem

more appropriate. The £650,000 proposed in the consultation document would appear more than adequate in this context.

In terms of excess, to ensure consumer protection a relatively modest excess would seem appropriate and in this context we have no issues with the proposed maximum £5,000 excess.”

Some respondents questioned the use of insurance intermediaries as a comparator as they posed different risks. One claims management company said:

“I note that you have based the proposed figures on those which apply to general insurance intermediaries. I question whether this is an appropriate comparison given that the potential for loss arising from an error by an insurance intermediary is very much greater than the potential for loss arising from an error by a claims manager dealing with a financial services complaint. ... I believe that the average value of endowment mis-sale compensation claims is under £5,000. These claims are the bread and butter of those dealing with financial services complaints. If the excess is to be set at a figure which exceeds the value of the majority of individual cases then, in effect, the practitioner is paying for insurance that is unlikely to be capable of covering any claim that might be made against him or her. If the intention of the requirement to take out PII is to protect the consumer, it will fail to do so.”

Many other responses stressed that different services in different sectors bore different risks.

There was concern over the cost, particularly to small businesses. However, it was also suggested that linking the level of excess to turnover did not take into account high value claims.

---

**5. Should the requirement be introduced from 1 January 2008 or at an earlier date?**

The introduction of compulsory PI insurance for authorised businesses on 1 January 2008 was supported by some as it allowed businesses sufficient time to obtain cover.

Some wished for the requirement to be introduced as soon as possible as regulation is already in force. Those that supported the immediate introduction of PI insurance also acknowledged that businesses needed time to obtain cover.

AXA Insurance acknowledged that the date would be dependent on the market and ability to obtain PI insurance cover.

A claims management company suggested a later date as “given that we have already had to pay fees for the first year of regulation, it would be unreasonable if further costs associated with the regulatory process were to put us out of business before the completion of that first year.”

Many favoured a later date as businesses might have already planned for the current financial year.

Capita suggested that businesses could apply for PI insurance when renewing other insurance or applying for renewal of their authorisation. The LCS said that it should be a “mandatory requirement to produce a copy of their professional indemnity insurance certificate to the Regulator within a specified time of renewal or, preferably, prior to application for annual renewal of their registration.”

A claims management company suggested a six-month period between publication and implementation of Rules.

The possibility of retrospective PI insurance was raised by the SRA but strongly opposed by a claims management company. It was suggested that PI insurance only be available to claims processed after the introduction of the Rules as the cost of PI insurance would increase fees and costs tend to be agreed with clients from the outset.

One claims management company highlighted that “It would be difficult to get cover for claims already in progress, because, as the DCA has itself identified, the insurers may insist on changes to process before it will provide cover. It would also seem appropriate that a training and competence scheme should be introduced and have time to bed-in before PII becomes compulsory. Otherwise each insurer is likely to have their own requirement for staff competence and thereby leading to inconsistencies across the industry.”

Some responses referred to the Financial Services Compensation Scheme and one response suggested that a similar scheme be established for those businesses that are unable to obtain PI insurance by the deadline.

## Conclusion and Next Steps

1. The introduction of rules that would require some or all authorised businesses to have professional indemnity insurance is a serious matter. Such requirements should only be introduced where it would be proportionate and clearly in the interests of consumers to do so. The consultation responses raise a number of important points often based on different interpretations of what professional indemnity insurance actually covers and how it operates in relation to different types of claims management businesses.
2. The Department has therefore commissioned an independent insurance expert to review the potential requirements, the market position and to consider the consultation responses. His report provides an objective examination of the practicalities of introducing compulsory insurance in this area, in what form and in respect of what types of businesses. The Report identifies the role of PI insurance as protecting the interests of the policyholder rather than the client. The issues raised were considered further, in consultation with the Regulatory Consultative Group.
3. From discussions with the Regulatory Consultative Group, it is accepted that regulation has already made considerable progress and is able to deal with any emerging issues robustly. However, it is necessary to determine whether any actionable risks remain outside the regulatory ambit and if such a risk does exist, whether PI insurance would be available, provide a remedy to consumers, and be a proportionate burden on businesses.
4. One of the issues consulted on in the consultation was the timing of the introduction of any compulsory PI insurance. The consultation had suggested January 2008. While some favoured an earlier date, most acknowledged that it is simply not functional to introduce a PI requirement at short notice. If some businesses are to be required to have PI insurance then the earliest functional date is April 2008. It is already clear that a requirement cannot be made for introducers to have PI cover as there is no insurable risk and the level of consumer detriment is technical and slight. The high-risk categories appear to be those representing clients in criminal or personal injury claims.
5. Final recommendations and PI insurance Rules will be published in the autumn.

## **Consultation Co-ordinator contact details**

If you have any complaints or comments about the **consultation process** rather than about the topic covered by this paper, you should contact the Ministry of Justice Consultation Co-ordinator, Laurence Fiddler, on 020 7210 2622 or email him at [consultation@justice.gsi.gov.uk](mailto:consultation@justice.gsi.gov.uk)

Alternatively, you may wish to write to the address below:

**Laurence Fiddler  
Consultation Co-ordinator  
Ministry of Justice  
5<sup>th</sup> Floor Selborne House  
54-60 Victoria Street  
London  
SW1E 6QW**

If your complaints or comments refer to the topic covered by this paper rather than the consultation process, please direct them to the contact given on page 3.

## The Consultation Criteria

The six consultation criteria are as follows:

1. Consult widely throughout the process, allowing a minimum of 12 weeks for written consultation at least once during the development of the policy.
2. Be clear about what your proposals are, who may be affected, what questions are being asked and the timescale for responses.
3. Ensure that your consultation is clear, concise and widely accessible.
4. Give feedback regarding the responses received and how the consultation process influenced the policy.
5. Monitor your department's effectiveness at consultation, including through the use of a designated consultation co-ordinator.
6. Ensure your consultation follows better regulation best practice, including carrying out a Regulatory Impact Assessment if appropriate.

**These criteria must be reproduced within all consultation documents.**

## **Annex A – List of Respondents**

1. AAG Plc
2. Accident & Claims Specialists
3. ACM ULR
4. Aqualibra Claims Ltd
5. Association of British Insurers (ABI)
6. Association of Personal Injury Lawyers (APIL)
7. Autocrash Services
8. AXA Insurance
9. Bob the Bankbuster
10. Browne Jacobson LLP
11. Caroline Ley
12. CLAIMS UK
13. Direct 2 Solicitors
14. Endowment Investigations Ltd
15. Forum of Insurance Lawyers (FOIL)
16. Freeclaim Midlands
17. Friends Provident
18. Interactive Law
19. John Eastwood
20. Justice Direct
21. Kennedys

22. Law Society
23. Legal Complaints Service (LCS)
24. Liverpool Law Society
25. MorganGreen Ltd
26. National Accident Helpline
27. Renaissance Endowment Review Services Ltd
28. Solicitors Regulation Authority
29. Sterling West & Associates Ltd
30. The Capita Group Plc
31. Three Branch Place Ltd
32. Whitehall Randall

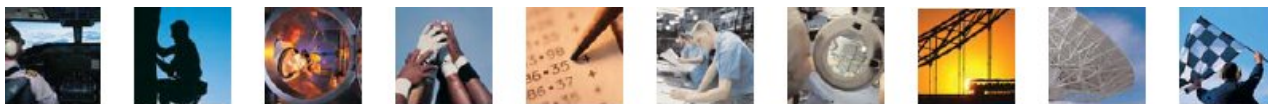


# An Assessment of the Market for Professional Indemnity Insurance for Claims Management Businesses Authorised under the Compensation Act 2006

July 2007

FINEX





## 1. Our Brief

To provide an assessment of the market for Professional Indemnity Insurance (PII) for Claims Management businesses authorised under the Compensation Act, covering the protection that would be given to the public and the costs and benefits to the businesses.

In preparation for this report we have considered the following documents;

Claims Management Services Regulation Baseline Study – 23/4/2007.

Claims Management Regulation – Professional Indemnity Insurance consultation paper (CP0407).

The Executive Summary from the Professional Indemnity insurance consultation paper states;

“Businesses that provide claims management services must be authorised under the provisions of the Compensation Act 2006. The act allows the Regulator to make rules in respect of professional indemnity insurance. In the consultation on the Rules of Conduct for authorised businesses it was accepted that while Professional Indemnity (PI) insurance was desirable the requirement could not be introduced immediately as some businesses would have difficulty obtaining cover.

PI insurance would help to protect consumers who might otherwise suffer loss in the event that an authorised business was unable to meet its liabilities. However, PI insurance cannot protect consumers in all circumstances, and it is costly for businesses. The premium may be around 1% of turnover compared with regulatory fees of under 0.4%.

There is no strong case for requiring businesses that do not have a contract with clients to have PI insurance. For those businesses that do, the proposal is to replicate the Financial Services Authority's requirement in respect of general insurance intermediaries.

The following requirements are put forward for consultation:

- (a) Authorised businesses that have contracts with client, whether or not they represent clients, should be required to have PI insurance.
- (b) Cover should provide for individual claims up to £650,000 with an aggregate limit of £1 million or 10% of annual income if higher.
- (c) The excess should be not more than the higher of £5,000 or 3.0% of annual income.
- (d) The requirements should apply from 1 January 2008.”

We have also quoted the consultation paper regarding the requirement to have Professional Indemnity insurance and this is set out in appendix 1.

## 2. Key Terms

### Professional Indemnity Insurance

#### Claim

The request by an insured for protection against a legal liability, according to the terms of the policy issued by an insurer.

#### “Claims Made” Principle

Under “claims made” insurance, coverage is provided only for claims reported to insurers during the policy period. Therefore, the year of insurance upon which a claim falls is the date on which the claim is first made against the insured and not the date of the error.

#### Duty of Disclosure

A common law duty on the part of an insured to disclose to the insurer any material facts that would influence the insurers in accepting or declining the risk, or in fixing the premium or the terms and conditions of the contract.



## Excess

The first portion of a loss or claim which is borne by the insured. An excess can either be voluntary to obtain premium benefits, or imposed for underwriting reasons. Only the amount above the excess is recoverable.

## Indemnity

A principle whereby the insurer seeks to place the insured in the same position after a loss that he / she enjoyed immediately before the loss.

## Insurable Interest

For a contract of insurance to be valid the policyholder must have an interest in the risk to be insured.

## Material Fact

Any fact which would influence the insurer in accepting or declining a risk or in fixing the premium or setting terms and conditions of the contract is material and must be disclosed by a proposer.

## Negligence

"The omission to do something which a reasonable man guided by those considerations which ordinarily regulate the conduct of human affairs would do, or doing something which a prudent and a reasonable man would not do". *Blyth v Birmingham Water Works Co.* (1856).

## Rate

The premium is usually a rate percent applied to the gross fees / turnover of the firm. This basic or "normal" rate will be adjusted upwards or downwards for poor or good physical features of an individual risk.

## Retro-active Date

This is a restriction applied by insurers to exclude claims arising out of work undertaken prior to a specified date i.e. the retro-active date.

## Run-off cover

Cover for claims made against a business which has ceased trading for professional claims arising from previous work.

## 3. Our Approach

- To provide an insurance view
- To consider the responses from the consultation paper from an insurance angle
- Apply a test of suitability, feasibility and acceptability to insurance options

. We have also considered three interests;

- The interests of the public
- The interests of the claims management industry
- The interests of individual claims management companies

We consider that whatever decisions are made, it has to be;

- Fair to all three interests
- Fully recognise the public interests
- Provide an effective environment to implement risk management

Desirable principles in any future Professional Indemnity Insurance arrangement include;

- Firms should have as much freedom of choice from competing sources, if feasible
- Cover should be provided at as low an overall cost to the businesses as possible and ensure protection in all insurance market cycles
- The risk of substantial unforeseen claims on the industry should be minimised
- The arrangement should encourage the avoidance of risk

Any solution must be sustainable in all insurance market conditions.

## 4. Professional Indemnity Insurance – What is covered?

What is professional indemnity insurance?

Professional Indemnity insurance indemnifies professionals against their legal liability to third parties for injury, loss or damage arising from their negligent acts errors or omissions committed in the course of their professional duties.



The main features of professional indemnity insurance.

- Professional indemnity insurance covers the firm and not the interests of their client or third parties
- The policy will only pay when the liability of the claimant has been established
- The duration of the policy is usually one year
- Premiums represent a significant cost in a firm's running costs
- The policy will cover the cost of legal defence in the event of a claim being made
- Professional indemnity insurance is written on a "claims made" basis. This means that cover relates to claims or potential claims against the firm notified during the period of insurance, irrespective of when the alleged negligent act or omission occurred (subject to the application of a "retro-active date" which is defined in the section "Key Terms").

## 5. Who buys PII? – other professions

Professional Indemnity insurance is bought by a far wider range of professions and quasi professions than ever before. It is compulsory for most professions to purchase professional indemnity insurance. This compulsion can be by:

- Regulation
- Requirement by the professional body
- Clients

The Claims Management Regulation Professional Indemnity Insurance Consultation Paper sets out the proposed requirements for PII and also quotes the FSA's compulsory requirements. By way of example and for comparative purposes, set out in appendix 2 is a table showing examples of the level and basis of cover other professions buy. The one profession in the table where cover is not a compulsory requirement by the professional body are the engineers. However, nearly all clients insist on having evidence of PII being purchased. There are of course a number of other professions who require PII as well as non- professions such as Lloyd's managing agents.

## 6. Risk Analysis

The Claims Management Services Regulation Baseline Study considers in some detail the scope of potential malpractice. From an insurance view point it is important to analyse the risks inherent in claims management activities.

In order to set the correct premium rate insurers need to understand the risk they are being asked to underwrite. This will involve studying both the severity and frequency of potential claims. The baseline study highlights the range of activities with risks assessed from high to low both in terms of frequency and severity.

The challenge for insurers will be understanding this relatively new business along with the evolving nature of claims management services activity.

## 7. Rules which already apply within the Act

We note that where client money is held then this must be in accordance with prescribed client account rules, which are modelled on those of the Council for Licensed Conveyancers.

We understand that the PII requirements do not state that cover must be included for risks associated with loss of client funds, such as dishonest acts. This is an important factor for insurers as their rating will increase significantly to include cover for this risk.

## 8. Insurance Market Overview

The insurance market is a competitive business affected by the same economic factors as any other business with pricing influenced by sale and demand.

The insurance market is also cyclical in its nature, in that apart from the issues of the individual risks, the prevalent conditions for setting premium and assessing risks tend to fluctuate. This fluctuation is between what is termed "soft" and "hard" markets with each stage often lasting several years. A hard market is characterised by more cautious underwriting, reduced availability of insurers capacity and increasing premiums. We are currently experiencing a "soft" market.



Encouraging insurers to participate through both “soft” and “hard” market conditions will be a crucial part of the process. Insurers must demonstrate competitiveness, flexibility and a strong financial rating for consumer confidence.

## 9. Summary of the Consultation Responses

The questionnaire set out five questions:

Question 1. Is it accepted that those businesses that are only introducers should not be required to have PI insurance?

Question 2. Should businesses that represent clients have PI insurance?

Question 3. Should business that have contracts with clients, but do not represent them have PI insurance?

Question 4. What should the minimum levels of indemnity and excess be?

Question 5. Should the requirement be introduced from 1 January 2008 or at an earlier date?

There were 31 respondents to the consultation. From the responses the following percentages were attained:

1. Is it accepted that those businesses that are only introducers should not be required to have PI insurance?

Yes 75% No 16% Did Not Know (DNK) 9%.

2. Should businesses that represent clients have PI insurance?

Yes 84% No 13% DNK 3%

3. Should businesses that have contracts with clients but do not represent them have PI insurance?

Yes 62% No 24% DNK 16%

4. What should the minimum levels of indemnity & excess be?

£2M (Same as solicitors)	13%
As stated in report	28%

£1-5M	6%
Do Not Know	22%
£5k x/s or higher	3%
100k Limit lower than 5k x/s	9%
Lower than 5k x/s	6%
Specific limits to types of business	9%

5. Should the requirement be introduced from 1st Jan 2008 or at an earlier date?

Earlier	40%
1st Jan 2008	29%
Later	9%
Do Not Know	22%

## 10. Insurers Approach to assessing the risk

In Section 8, Insurance Market Overview, we explained that the insurance market is cyclical in its nature. Currently, the market is very competitive with rates continuing to reduce as there is a surplus of insurer capacity.

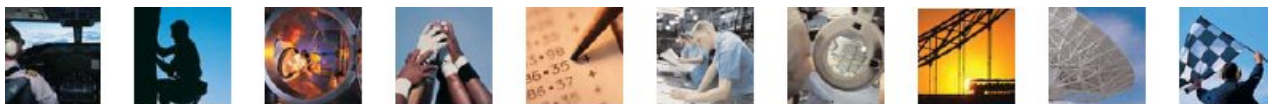
The timing for introducing a compulsory PII requirement is good, but any arrangement must be sustainable.

Reference is made in the Baseline Study to a period when IFA's were unable to purchase PII in accordance with the regulations, which led to a suspension of the rules for a period of time. There has been further instances, such as in the surveying field with property valuation work following the property downturn in 1999/2000 and more recently actuaries during the last hard market in 2001/2.

Insurers want to write business which is stable and profitable for them. They need statistics on risk and claims in order to actuarially price the product. This is difficult with the new trading environment – an increased risk for insurance.

Factors which could affect insurers include:

- poor claims experience in the claims management field
- hardening market conditions across the insurance market as a whole
- Insurers shareholders pressure on their investment



- Restrictions imposed by their reinsurers
- Claims history in related professions such as solicitors and IFA's
- A crash or dip in the financial markets
- A lack of awareness within the insurance market of claims management companies
- Economic recession
- Fluctuation in interest rates

In time, insurers will develop accurate rates for the claims management services risk – varying according to type of activity being undertaken.

Any insurance solution is critical upon high levels of competence and the need to eventually improve and develop standards.

The concept of backing any new system within insurance can be difficult to quantify and, like the system itself, we would envisage that any solution will evolve over time as teething problems emerge and new factors come into play along with changing insurance market conditions.

## 11. PII Options

There are a number of ways in which PII can be arranged. Some of these are more descriptive than others and of course some provide far more extensive cover than others. This may be a requirement of a particular professional body or regulator for a variety of reasons – including protecting the public.

Set out below are some broad examples of such arrangements starting with ones which provide the narrowest cover.

### Option 1 - Open Markets – Voluntary

Cover is placed independently by firms in the commercial insurance market. There is no specified level of cover or limit of indemnity. Wordings tend to be restricted and the limit of indemnity is aggregate in the year.

### Option 2 - Open Market – Compulsory Minimum Terms

As above, except the basis of cover and/or limits of indemnity are compulsory to comply with.

### Option 3 - Approved Insurer

As per the example immediately above, but with a requirement for insurers to be approved by the regulator or professional body. The cover tends to be much broader, for instance, the limit of indemnity is on an any one claim during the year basis. There will also be special conditions in the event of innocent non disclosure or mis-representation which are to the benefit of the insured.

### Option 4 - Master Policy

This is an arrangement where a single insurance policy is issued by commercial insurers to a body representing the members of a profession and covers every member of the profession within limits and terms and for a premium that is predetermined by agreement between the master policyholder and insurers.

### Option 5 - Mutual Fund

This is an arrangement under which members of the group decide and agree to pool the risks of all of them and to contribute to the losses that might be incurred by all or any of them. The mutual sets the terms of indemnity to its members which are the same for all; the mutual sets the contribution each member must make and establishes the administrative arrangements for managing the mutual.

Option 1 has been discounted as it does not provide public protection in all cases.

Option 2 is the one currently being proposed. It is potentially sustainable through different insurance market cycles, provides a minimum level of public protection and gives freedom of choice to firms as to where to buy their PII subject of course to the minimum terms.

Option 3 is a more expensive option as cover is significantly broader. It is also potentially less likely to be sustainable in a hard insurance market as the claims management services industry does not have a long term track record in buying PII.

Option 4, as Option 3 above, but it would require more administration costs and time in running the scheme. This would obviously be less financially attractive to firms.



With regard to Option 5, a key feature of a mutual is to ensure a homogenous group. From the Baseline Study it is clear this is not the case here.

## 12. Specific PII issues

We have highlighted below a number of areas which have not been specifically addressed elsewhere in this paper, but need to be taken into account when considering PII requirements.

### Additional Responses to Consultation Paper

We noted within the responses a wide variety of views on historical PII rates and commentary on how they are set. It is important for there to be a common understanding of premium rates.

### Liability for Past Acts

Should compulsory PII be required from 1/1/08 it is important to address the question of potential liability arising from work undertaken prior to this date.

For those firms who currently buy PII, cover is most likely to be provided for past work. However, for those firms who do not buy PII they may have a retro-active date limitation applied to their policy. Insurers normally either exclude past work when insuring firms who have never previously brought PII or, on request charge an additional premium to include some level of prior work cover.

### Run-off Cover

This is defined in Section 2. Key Terms. When a firm ceases to trade there will be a question of whether cover must be maintained for a specified period in order to cover claims which may be made from work previously undertaken. This again, is a public protection point.

### Self-insured Excess Levels

For consistency with the FSA the Consultation Paper it is suggested having the same maximum excess level. Issues can arise here regarding the terms of the excess (either aggregate or each and every claim) and how the

insurance market responds to this. Our paper does not address these points as the FSA terms are silent.

## 13. Timescales

The majority of respondents to the Consultation Paper expressed a preference for compulsory PII to commence on or before 1/1/08. Our view is that the earliest feasible date would be 1/1/08. The reason for this is that it is essential to raise awareness amongst insurers of the claims management services industry and its risk profile. It is also necessary to gauge insurers appetite for providing cover as set out in the Consultation Paper. Insurers questions and concerns need to be dealt with. The importance of creating as much interest as possible amongst insurers for writing this type of business cannot be understated.

## 14. Conclusion

The majority of respondents to the PII Consultation Paper agreed that:

- Those business that are only introducers should not be required to have PII
- Businesses that represent clients should have PII
- Businesses that have contracts with clients, but do not represent them should have PII

The diversity of claims management services is also clear from the consultation and baseline study. Some areas are, for instance, small business high volume, with limited potential liability.

The argument, therefore, regarding different limits for variable types of business is compelling. The insurance industry should be able to offer varying limits of cover.

In this paper we have considered the interests of - the public - the claims management industry - individual claims management companies - from an insurance perspective.

Premium rating will ultimately be dependent upon insurers perception of the risks (as described in section 10). There is an additional challenge with this new industry group in that insurers will be asked to assess



start up firms. This means that insurers will look to review the previous business experience of the individuals. There are no pre-set minimum premium levels, however, it is likely that the level could be in the region of £650 to £1,000.

To achieve the appropriate level of protection of public interest with public confidence in that protection, as well as the protection of individual firms and the businesses as a whole, the insurance arrangements should have minimum uniform terms and conditions which are acceptable to the public and to the businesses.

An important criterion will be to ensure that any variants in the limit of cover are clearly understandable to the public in respect of different types of activity.

From a regulatory perspective it would be clearer to have a consistent PII requirement matching the FSA.

The timing for introducing PII is good in that the insurance cycle is currently in a competitive phase. There is, however, work to be done to familiarise insurers with the claims management services industry. Ultimately, rating will depend on insurers assessment of the risks presented to them. Insurers will of course be cautious with the risks associated with a new industry and with new risks constantly evolving.

It is also important to strike a balance between PII minimum terms and conditions and how much cover the insurance industry is prepared to give in order to make the terms as sustainable as possible in all insurance market cycles.

The timescale for implementation should be 1/1/08 at the earliest as it is vital to gain as much insurer interest as possible to create a dynamic PII market.



## Appendix 1

Within the "proposals" section of the Claims Management Regulation – Professional Indemnity Insurance Consultation paper it is stated;

The requirement to have Professional Indemnity (PI) insurance

Section 9 of the Compensation Act 2006 empowers the Secretary of State to make Regulations about authorisations. Paragraph 11 of the Schedule to the Act provides –

- "11 (1) Regulations may require, or permit the Regulator to require, an authorised person to take out a policy of professional indemnity insurance in respect of his actions in the course of providing or purporting to provide regulated claims management services.
- (2) Regulations under sub-paragraph (1) may, in particular –
- (a) make provision about the level or nature of insurance cover to be provided by the policy;
  - (b) include provision about failure to comply (which may, in particular, provide for compliance to be treated as a condition of authorisations or enable the Regulator to impose conditions on, suspend or cancel authorisations)."

Paragraph 21 of the Regulations provides:

"The Regulator may, by written notice, require an authorised person to take out a policy of professional indemnity insurance in accordance with specified conditions in respect of the person's activities in providing regulated claims management services."

Paragraph 7 of the Rules of Conduct provides:

"A business shall maintain professional indemnity insurance in accordance with any rules made by the Regulator. (There are currently no additional rules but it is expected that rules will be consulted on and made by summer 2007.)"

Professional indemnity insurance was covered in the consultation on the rules of conduct DCA CP(L) 12/06. The following is reproduced from the Summary of responses to the DCA's consultations on claims management regulation (CP® 12, 18, 22 and 22A/06)

"Question 6: Should holding professional indemnity insurance be a requirement for authorisation? Would it be possible in practice for authorised businesses to obtain such insurance from the outset or should requirements be phased in to allow sufficient time for a market to develop?"

### Summary of responses

This question is closely related to question 8 of the consultation on the draft regulations considered above, and therefore provoked similar responses. There was general acceptance of the need for authorised businesses to have professional indemnity insurance. However, it was also noted that it might not be easy for all business to obtain such insurance at short notice.

### Conclusions

As outlined above the need for professional indemnity insurance is accepted. However, there is a question as to whether all businesses should be required to have insurance or whether, for example, this should not be a requirement for introducers.

It would be unreasonable to impose a requirement for PI cover immediately. Some businesses may find it difficult to obtain cover and at the least such a requirement would delay the authorisation process.

The DCA will consider requirements for professional indemnity cover. There will be full consultation before the requirements are introduced, which will be in 2007/08."

### Timetable

The planned timetable is:

- 25 May 2007: closing date for responses to consultation
- June 2007: rules published
- 1 January 2008: rules come into force.



## Appendix 2

Provision	The Royal Institution of Chartered Surveyors Minimum Terms and Conditions	The Institute of Chartered Accountants Minimum Terms and Conditions	The Law Society's Minimum Terms and Conditions	The Architects Registration Board Minimum Terms and Conditions	The Association for Consultancy and Engineering Minimum Terms	FSA Insurance Brokers
<p><b>Minimum level of cover</b></p>	<p>£250,000 where the gross fee income of the practice in the last financial year was less than £100,000.</p> <p>£500,000 where the gross income of the practice in the last financial year was between £100,000 and £200,000.</p> <p>£1,000,000 where the gross income of the practice in the last financial year exceeded £200,000.</p> <p>However, the Institute advises members that the above guidelines are the minimum amount of cover required and advises that most members would be advised to carry at least £500,000 of cover.</p>	<p>If the gross fee income of a firm is less than £400,000, the minimum limit of indemnity for any one claim and in total must be equal to two and a half times the gross fee income of:</p> <ul style="list-style-type: none"> <li>- £50,000 for a sole practitioner;</li> <li>- in any other case £100,000</li> </ul> <p>Except where the above applies, the minimum limit of indemnity must be £1,000,000 for any one claim and in total.</p>	<p>The sum insured for any one claim (exclusive of Defence Costs) must be, where the Firm is a Relevant Recognised Body, at least £3 million, and in all other cases, at least £2 million.</p> <p>Or £3,000,000 if an LLP.</p>	<p>£250,000 where the gross fee income of the practice in the last financial year was less than £100,000.</p> <p>£500,000 where the gross income of the practice in the last financial year was between £100,000 and £200,000.</p> <p>£1,000,000 where the gross income of the practice in the last financial year exceeded £200,000.</p>	<p>Not compulsory.</p>	<p>A minimum limit of indemnity of 1 million Euros for a single claim, and the higher of 1.5 million Euros or 10% of the broker's annual income in aggregate. Where the policy limits are not denominated in Euros, the broker must take steps at renewal to ensure the limits are at least equivalent to those required.</p>