

# **Feedback Statement and Final Consultation on Professional Indemnity Insurance for Fiduciary and Investment Sectors**

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**Contents**

Background..... 3

Professional Indemnity Insurance ..... 4

*What was the general message in the feedback?*..... 4

*Key outcomes of the Consultation for Fiduciary Licensees* ..... 4

*Key outcomes of the Consultation for PoI Licensees* ..... 4

*What is the Commission going to do next?* ..... 5

*Specific Feedback and Changes*..... 5

## Background

In our December 2021 [Consultation Paper on Professional Indemnity Insurance](#) we asked for feedback on the proposed changes to requirements concerning professional indemnity insurance (“PII”) for the fiduciary and investment sectors, as set out in the Consultation Paper on Professional Indemnity Insurance Fiduciary and Investment Sectors (“CP”).

A total of 47 parties responded to the CP. These comprised fiduciary licensees, entities licensed under the Protection of Investors (Bailiwick of Guernsey) Law (“PoI licensees”), dual licensees (licensed under both the Fiduciaries Law and the PoI Law), industry representative bodies, insurers and other industry participants.

The Commission would like to thank all those who provided feedback to the CP.

## Professional Indemnity Insurance

### *What was the general message in the feedback?*

The Commission published the CP to seek stakeholders' views on proposed changes to the rules in respect of the maintenance of PII. The protection of the public against financial loss due to dishonesty, incompetence or malpractice by persons carrying on finance business is a statutory function of the Commission. One of the ways the Commission carries out this function is to require that certain financial services businesses maintain PII.

The purpose of the CP was to seek stakeholders' views on changes to the current PII rules to modernise them whilst ensuring that customers are protected in the event of losses from licensees' negligent acts, errors or omissions in their professional capacity.

In general most of the respondents broadly supported the proposals in the CP. The range of the responses reflected the industry sectors and the relative size of the firms, and for some proposals there were equal numbers agreeing and disagreeing with them. A number of the respondents reported that some of the proposed changes would be particularly onerous in the current challenging PII market and the Commission is not proposing to take these forward at this time.

### *Key outcomes of the Consultation for Fiduciary Licensees*

- The basis of the calculation of the minimum required level of cover will remain turnover from regulated fiduciary activity but Fiduciary licensees will be required to consider whether the minimum indemnity limit and scope of cover of their PII policy is appropriate for their businesses, taking into account possible claims which may also be made from non-regulated activity.
- Minimum required level of cover will be capped at the lower of 3 times fiduciary turnover or £10m
- The maximum excess restriction of 3% of turnover from regulated activities has been removed on the basis that the rules will continue to require additional financial resources equal to the excess amount are held.
- PII will be required to cover legal defence costs but the proposal that legal defence costs should not erode the aggregate limit ("legal defence costs in addition") has been withdrawn on the basis that this provision may not be readily available in the market and may limit licensees' ability to obtain overall cover.
- A rule has been introduced clarifying that dual licensees should meet the PII rules under whichever of the respective regimes requires the higher (or highest) aggregate minimum indemnity limit, unless otherwise instructed by the Commission. For dual PoI/Fiduciary licensees this will normally mean that the PoI Capital Adequacy Rules<sup>1</sup> will take precedence.

### *Key outcomes of the Consultation for PoI Licensees*

- The basis of the calculation of the minimum required level of cover has changed from total revenue to income from controlled investment activity and any other regulated activity. Licensees will be required to consider whether the minimum indemnity limit and scope of cover of their PII policy

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<sup>1</sup> The Licensees (Capital Adequacy) Rules and Guidance, 2021

is appropriate for their businesses, taking into account possible claims which may also be made from non-regulated activity.

- Minimum required level of cover will be capped at the lower of 3 times total regulated income or £10m
- The definition of “net assets” in the Capital Adequacy Rules will include an adjustment deducting an amount equal to the PII excess. As a consequence some licensees may be required to hold a higher level of capital. The current maximum excess restriction of 20% of total insured will be removed.
- PII will be required to cover legal defence costs but the proposal that legal defence costs should not erode the aggregate limit (“legal defence costs in addition”) has been withdrawn on the basis that this provision may not be readily available in the market and may limit licensees’ ability to obtain overall cover.
- A rule has been introduced clarifying that dual licensees should meet the PII rules under whichever of the respective regimes requires the higher (or highest) aggregate minimum indemnity limit, unless otherwise instructed by the Commission. For dual PoI/Fiduciary licensees this will normally mean that the PoI Capital Adequacy Rules will take precedence.

### *What is the Commission going to do next?*

Alongside this feedback statement the Commission has issued final drafts of the relevant amended Rules wording, taking into account comments received during the consultation. A final eight-week consultation period is being offered to provide an opportunity to identify any “fatal flaws” in the draft amended rules, after which amendments will be formally adopted.

### *Specific Feedback and Changes*

A more detailed summary of the responses received to each question in the CP, together with the Commission’s feedback, are presented below.

#### **Cap on the level of PII cover required**

##### **FIDUCIARY** and **INVESTMENT**

#### **Q1: Do you have any comments on the proposal to introduce a cap of £10,000,000 on the required minimum level of PII cover under the Capital Adequacy Rules and the Fiduciary Rules<sup>2</sup>?**

All respondents agreed that a cap on the required minimum level of PII should be introduced. The majority of responses received supported setting this cap at £10,000,000 but other views were received suggesting that the cap might be set at a different level. Two respondent licensees suggested that £15,000,000 would be more appropriate, based on their own risk analysis.

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<sup>2</sup> The Fiduciary Rules and Guidance, 2021

Four responses from the investment sector suggested that a level of £5,000,000 may be more appropriate, would impact a greater number of licensees, and be in line with that of a peer jurisdiction.

Several licensees indicated in their responses that they would continue to hold aggregate cover at levels in excess of £10,000,000 based on their own internal risk assessment, irrespective of the introduction of any cap on the required minimum level.

### *Commission response*

Given that all respondents agreed with the proposal to introduce a cap, the Fiduciary Rules and the Capital Adequacy Rules will be amended to include this change.

The Commission noted the request for a lower level of cap for the investment sector. However, the Commission has considered that £10,000,000 remains appropriate. The Commission takes the view that an aggregate level of £5m may be inappropriate for the level of activity and potential liability of medium-sized and larger firms. As a reminder the required minimum level of cover remains a dynamic, turnover-based measure and many smaller firms will continue to require cover below the £10m cap. This change does not increase the minimum requirement for any firm.

A new Rule 4.1(2A) and guidance have been added to the Fiduciary Rules to implement this change.

For PoI licensees, the existing PII requirements under the Capital Adequacy Rules will be transferred from Part 2 Financial Resources to a new Part 2A (Insurance Arrangements). This change provides better clarity as financial resources requirements will be separated from insurance requirements. The introduction of the “cap” can be seen in Rule 2A(6) and guidance in the new Capital Adequacy Rules.

## **Cover per claim**

### **INVESTMENT**

**Q2: Do you have any comments on the proposal to provide greater clarity regarding the level of aggregate and limit for each and every loss?**

Almost all parties that responded to this question agreed with the proposal that the minimum level of PII cover should apply to both the aggregate cover and the limit for any one claim. Comments were received noting the benefit of aligning this requirement for the fiduciary and investment sectors and the potential for increased investor protection.

### *Commission response*

The Capital Adequacy Rules will therefore be amended by adding “for any one claim and in the aggregate”, where relevant, to rule 2A(2) and (4).

## **Level of cover: Three times total revenue/income**

### **FIDUCIARY**

**Q3: Do you have any comments on the proposal to include income received from non-regulated activities within “turnover” when calculating the level of PII cover under the Fiduciary Rules?**

Around half of the respondents agreed with the proposal citing the benefit of greater consistency and clarity. Some also highlighted that they did not expect any impact from the change, given that fiduciary licensees, except for dual licensees, do not generally engage in other activities apart from fiduciary regulated activities.

Those that disagreed made the argument that income from unregulated activity does not translate into increased claims risk, in a similar way as income from proprietary trading.

### *Commission response*

It has been decided that the proposal is not to be implemented and that turnover from regulated fiduciary activity will continue to apply. However a new rule (Rule 2B) has been added, requiring that for licensees which also carry out unregulated activities, consideration must be given as to whether the minimum indemnity limit of their PII policy is appropriate for their businesses, taking into account possible claims which may also be made from non-fiduciary activity.

### **Gains from proprietary portfolio trading**

#### **FIDUCIARY** and **INVESTMENT**

**Q4: Do you have any comments on the proposal to exclude gains or other investment income from a licensee's proprietary investment portfolio when calculating the level of PII cover under the Capital Adequacy Rules and the Fiduciary Rules?**

The majority of respondents supported this proposal.

Some respondents suggested that further exclusions could be made for other categories of income.

### *Commission response*

#### **FIDUCIARY**

Given that the decision has been made that turnover from fiduciary regulated activities will continue to apply when calculating the limit of indemnity for the PII policy, gains or income from a licensee's proprietary investment portfolio trading would automatically be excluded from the calculation.

#### **INVESTMENT**

The CP originally proposed using total revenue, net of gains from proprietary trading, as the basis of the calculation of the required limit of indemnity. However, after reviewing feedback and assessing our data (that indicates the difference between total revenue and income from all regulated activity is generally minimal), the Commission will implement an approach of simply relying on regulated income. In a minor change to existing rules "total revenue" will now be replaced by "income from controlled investment activity and any other regulated activity". Income from other regulated activity in the case of dual POI/Fiduciary licensees will include regulated activity within the meaning of the Fiduciaries Law.

Similar to the Fiduciary Rules, a new rule will be added to the Capital Adequacy Rules requiring that for licensees which also carry out unregulated activities, consideration must be given as to whether the minimum indemnity limit of their PII policy is appropriate for their businesses, taking into account possible claims which may arise from this other activity.

The Commission's data shows that the difference between total revenue and income from controlled investment business for most PoI licensees is minimal. This, together with feedback received requesting for certain income categories to be excluded, the Commission deems that a simpler approach of relying on regulated income (for fiduciary or investment, as the case may be) for the calculation of level of PII cover would be more appropriate than capturing total income with permitted deductions of various items (such as gains from proprietary trading, income from sub-letting premises, etc.), as originally proposed in the CP.

### The minimum PII cover for PoI licensees

#### INVESTMENT

**Q5: Do you have any comments on the proposal to amend the Capital Adequacy Rules to require a Designated Trustee (“DT”), Designated Custodian (“DC”) or Designated Administrator (“DA”) to hold minimum aggregate PII cover of £1,000,000 or three times turnover, whichever is greater?**

The majority of respondents agreed with this proposal.

#### *Commission response*

The proposed change will be implemented by amending the minimum requirement in Rule 2A(2) in the Capital Adequacy Rules from £300,000 to £1,000,000. This increased requirement reflects the core role such licensees fulfill in respect of the funds sector.

### Excess

#### FIDUCIARY and INVESTMENT

**Q6: Do you have any comments on the following proposals:**

**(1) to amend rule 4.1(3) of the Fiduciary Rules from “Any excess must not exceed 3% of turnover from regulated activities.” to “Any excess must not exceed 3% of turnover”.**

**(2) to deduct a PII excess when calculating “net assets” for the financial resources requirements under the Capital Adequacy Rules.**

All except two respondents agreed with the proposals. The two PoI licensees that disagreed with the proposal to deduct a PII excess when calculating “net assets” for FRR under the Capital Adequacy Rules deemed that the proposal was unnecessary or creates additional burden on licensees. One was of the view that the existing FRR calculation provides sufficient headroom in case a claim is made.

These proposals will be considered together with feedback received to Q7 below.

**Q7: Are you supportive of consideration of the removal of the absolute excess minimum requirements under the PoI and Fiduciaries frameworks and accompanying review of the applicable financial resources requirements under the respective Rules?**

All respondents except one agreed with this proposal. The party that disagreed with the proposal suggested that the removal of the absolute excess minimum requirements would encourage a race to the bottom, compared to the existing requirement whereby a proportionate minimum excess requirement helps encourage better outcomes.

Four respondents that agreed with the proposal also provided further comments on a review of the FRR. One suggested that assets accepted under the FRR should be in cash or near cash with a list of defined



suitable assets. Two commented that the FRR should remain commercial and logical. One licensee suggested that a review of the FRR is not needed. Two respondents, whilst agreeing with the proposal, highlighted that excess levels are constrained by what insurers are willing to provide in the market.

### *Commission response*

#### **FIDUCIARY**

Currently, the FRR Rules already require a deduction of one excess from the calculation of liquid assets required to be held. Having considered the feedback received, the Commission agrees to remove the absolute excess minimum requirements for fiduciaries by removing the current Rule 4.1(3) from the Fiduciary Rules and adding a guidance stating that licensees should consider the level of excess of their PII policy and their ability to pay the excess should a claim arise.

#### **INVESTMENT**

Noting the industry support in responses to the consultation, the proposal to deduct the PII excess when calculating “net assets” for the financial resources requirements has been adopted in the Capital Adequacy Rules (see the revised definition of “adjustments” in Part 5 General Provision). The Commission notes that this change increases the required level of capital for all licensees and, in some cases, licensees may need to review the level of PII excess or the level of financial resources held to ensure compliance with the new requirement. Taking this amendment into account, and similar to the approach taken under the Fiduciaries regime, the current absolute excess minimum requirement (20% of the total insured) has been removed.

Licensees should contact the Commission if they wish to discuss the application of the policy for example in the case of licensees placing reliance on group PII cover.

### Dual or multiple licensees

#### **FIDUCIARY** and **INVESTMENT**

**Q8: Do you have any comments on the proposal to provide for a carve out for a fiduciary licensee or a PoI licensee (DT, DC or DA) which is also a bank or a licensed insurer whereby the licensee would only have to comply with the requirements issued under the Banking Law, IMIL or IBL as applicable?**

The Commission received mixed feedback on this proposal. Whilst generally respondents agreed with the proposed changes, comments were made that the prerequisite analysis prior to requesting a carve-out from the Commission may be overly burdensome. Some respondents suggested an alternative approach might be to apply the respective rule resulting in the comparatively higher (or highest) required level of cover.

### *Commission response*

The Commission has given consideration to the comments received and has introduced a rule to both sets of Rules that where a licensee also holds a licence under another Regulatory Law the licensee should meet the PII rules under whichever of the respective regimes requires the higher (or highest) aggregate minimum indemnity limit, unless otherwise instructed by the Commission.

## Self-insurance

### FIDUCIARY and INVESTMENT

#### **Q9: Do you have any comments on the proposal to no longer accept the use of self-insurance for Fiduciary licensees?**

Almost all respondents agreed with the proposal to remove reference to self-insurance from the Fiduciary Rules. Two respondents disagreed with the proposal, and although neither currently relies on self-insurance they indicated that this option should remain available.

The licensees that agreed with the proposal noted that the proposal is sensible as it ensures that risk is effectively transferred from the licensee. Half of the respondents that agreed with the proposal also requested that the Commission clarify that captive insurance is not regarded as self-insurance.

#### *Commission response*

Considering the feedback received, the current Rule 4.1(4) of the Fiduciary Rules has been amended and the reference to self-insurance has been removed, as proposed in the CP. The Rule now clarifies that captive insurance is accepted provided that such cover is provided by a Guernsey licensed captive insurer or a foreign captive insurer of equivalent status.

A similar clarification is also made to the Capital Adequacy Rules with the introduction of the new rule (Rule 2A(10)).

## Scope of cover

### FIDUCIARY and INVESTMENT

#### **Q10: Do you have any comments on the additional terms and conditions proposed to the Fiduciary Rules?**

#### **Q11: Do you have any comments on the proposed requirements concerning scope of PII for the Investment sector?**

The majority of respondents raised concerns about some of the proposals regarding scope of cover. Key concerns were in relation to proposals 2 and 3: defence costs to be in addition to the aggregate limit and reinstatement to take place when the cover is depleted. Some respondents also advocated more generally that the scope of cover should not be too prescriptive.

### FIDUCIARY and INVESTMENT

#### **Proposal that defence costs must not contribute to the individual loss or aggregate limit**

#### *Commission response*

The majority of concerns raised related to the difficulty in obtaining cover to meet this requirement. After further consideration and engagement with insurance market participants it has been decided not to proceed with the implementation of this proposal. Instead, the Fiduciary Rules and the Capital Adequacy Rules will require only that PII policies cover legal defence costs (Rule 4.1(5)(f) of the Fiduciary Rules and Rule

2A(9) of the Capital Adequacy Rules) and such costs may contribute to the individual loss or aggregate limit.

## **FIDUCIARY** and **INVESTMENT**

### **Reinstatement**

The CP proposed that in the event that a claim is made on the PII policy and causes the aggregate level of PII cover to deplete, the licensee must take actions to reinstate the level of cover. Most objections to this proposal were on the grounds of cost. One respondent made the point that the time it takes for a claim to be made and paid out is such that it may be unlikely that a depletion would take place within that same year. Another licensee argued that firms take out insurance for the year based on a number of assumptions, which is part of their annual process, and instead of a compulsory reinstatement, this should form part of considerations at renewal the following year. It was also noted from conversations with underwriters that a re-instated policy will not cover the same claim/event.

### *Commission response*

The Commission has considered all the feedback and has decided that this proposal is not to be implemented.

## **FIDUCIARY** and **INVESTMENT**

### **Liabilities for the dishonest or fraudulent acts of employees**

One of the proposals in the CP was to expand the scope of PII cover to include fraudulent acts, by adding “or fraudulent” to an existing rule (the current Rule 4.1(5)(b) of the Fiduciary Rules) and to introduce the same requirement to the Capital Adequacy Rules. Overall, respondents advocated for less prescriptive rules regarding scope of PII cover as bespoke wording may come at a cost and may limit the supply of available cover. Some licensees stated they have indemnity provided for dishonest or fraudulent acts of employees under a different insurance arrangement (not PII).

### *Commission response*

The Commission acknowledges the variety of drafting used in insurance policies, as highlighted by some respondents and insurers. In this regard, a guidance note will be added to explain that in meeting this rule, some licensees may rely on a different insurance instrument for indemnity against such liabilities, provided that the licensee is satisfied with such insurance arrangement. In addition, since PII policy wordings may vary, a licensee should consider whether its insurance provides the required scope of cover. For instance, these may be covered under “Crime”, “Fraud” or “Fidelity” under its policy. Some policies may contain limitation on “dishonest or fraudulent acts” such as a carve out on deliberate dishonest acts. Where there is such limitation or exception, the licensee should assess whether the policy is considered appropriate for its business.

## **FIDUCIARY** and **INVESTMENT**

### **Liabilities of its employees who, in the course of their duties to the licensed fiduciary, perform functions in their own names**

Feedback was received on the current Rule 4.1(5)(c) of the Fiduciary Rules. Some respondents argued that current Rule 4.1(5)(a) already covers this requirement.

### *Commission response*

The Commission takes the view that the scope of current Rule 4.1(5)(c) is broader than that of current Rule 4.1(5)(a) and is not proposing a reduction in the scope of these requirements. The rule has, therefore, been retained.

Some licensees and insurers suggested that it is important to consider the definition of employee to ensure that coverage is in place for past and future employees, seconded and contracted individuals. It should be noted that the Fiduciaries Law defines “employee” as “an individual who has entered into or who works under (or, where the employment has ceased, who worked under) a contract of employment”. The definition is generally fit for purpose. Consequently, a guidance is added to the Fiduciary Rules to explain that for the purposes of the new Rule 4.1(5), the PII policies should cover current and former employees and a person under contract to perform services or duties to or on behalf of the licensee. The guidance also recognises that time limitation may apply to the period of cover for former employees. In line with the above, Rule 2A(9)(a) and a guidance note are also introduced to the Capital Adequacy Rules.

## **FIDUCIARY** and **INVESTMENT**

### **Liabilities which the licensed fiduciary/ PoI licensee might incur in any jurisdiction in which it carries on business**

A respondent highlighted that clients may re-locate or their personal circumstances may change, which is commonly seen in the fiduciary sector. The respondent suggested that licensees should seek to obtain a worldwide cover, where possible, given the nature of the fiduciary business.

### *Commission response*

The Commission has considered the suggestion but takes the view that a “one size fits all” approach to this requirement is not appropriate and that to impose a world-wide coverage requirement may be overly burdensome for some licensees. Instead the rule has been amended to require cover for liabilities which a licensee might incur in any jurisdiction in which it should reasonably foresee that it may be held liable for damages and costs.

## Notification relating to PII

### **INVESTMENT**

### **Q12: Do you have any comments on the proposal to add notification requirements relating to PII to the Capital Adequacy Rules?**

Most responses agreed with the proposal. Two respondents noted that for a Group PII, the proposal may present problems where a notification does not concern the licensee, but other entities within the Group. One respondent stated that licensees may make a notification to their insurer as a matter of prudence and questioned whether this should also be notified to the Commission.

### *Commission response*

Currently, there is no specific notification requirements concerning PII within the Capital Adequacy Rules or the Conduct of Business Rules, but PoI licensees have been notifying the Commission, using the online Form 216 PI claims and Legal Proceedings, upon making a PI notification to their insurer. The Commission recognises that this practice meets Principle 10 of the Principles of Conduct of Finance Business which states that “a financial institution should deal with the Commission in an open and co-operative manner and keep the Commission promptly informed of anything concerning the financial institution which might reasonably be expected to be disclosed to it”. It has been decided that the Commission will continue to rely on notification on this basis. Guidance has been added to the Capital Adequacy Rules in this regard.

### Implementation of the changes

As indicated in the CP, the revised requirements will apply from the next PII policy renewal date following the date of the making of the new Rules. This will be implemented either via a general derogation of rules or a transitional provision in the final version of the relevant rules. In the meantime, licensees will continue to comply with the current requirements set out in the Fiduciary Rules or the Capital Adequacy Rules as applicable.

### Next steps

The changes as summarised above have been made to both the Fiduciary Rules and the Capital Adequacy Rules, including guidance. The draft rules are attached for fatal flaw comments by 5 August 2022.