

Consultation Paper on Professional Indemnity Insurance for Insurance Intermediaries and Insurance Managers

Closed 14 Feb 2022

Opened 8 Dec 2021

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Results updated 10 Jun 2022

A feedback statement on the consultation can be found at the link below. Alongside the 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. Comments may be submitted via the Commission's Consultation Hub (link [here](#)) where copies of the draft Rules can also be found.

Links:

- [Feedback Statement on the PII CP for Insurance Managers and Insurance Intermediaries](#)
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Overview

The Commission has been made aware by industry of an increasingly challenging Professional Indemnity Insurance (“PII”) market. Firms have found the availability of insurance reducing while prices are rising. The Commission has engaged with industry and other stakeholders through questionnaires and interviews. As a result of that engagement, the Commission is publishing this Consultation Paper to seek industry’s views on proposed changes to the rules around the maintenance of PII.

The Commission has engaged with the insurance sector and also the fiduciary and investment sectors. The issues surrounding price and availability are relevant for all sectors, but various factors differentiate the insurance industry from fiduciary and investment businesses. These factors include the exposure to retail customers; the location of customers; the nature of advice given within each sector; the average size of the firms; and each industry’s claims experience. The Commission is therefore carrying out a separate consultation for the insurance sector. Where appropriate the Commission has adopted consistent approaches across all industry sectors. A separate Consultation Paper making proposals in respect of PII for the fiduciary and investment sectors has also been published and is available on the Consultation Hub.

Summary of Proposals

The Consultation Paper proposes to loosen requirements where possible but also to ensure that the rules for PII are up to date and fit for purpose.

The Consultation Paper, which includes detailed proposals, can be found below.

The Commission would like to thank the licensees which participated in the surveys and interviews for their cooperation.

What happens next

Responses to this Consultation Paper will be considered by the Commission prior to issuing any new rules. A Feedback Paper will also be published, summarising the responses to the Consultation.

Related

 [Consultation Paper on Professional Indemnity Insurance for Insurance Intermediaries and Insurance Managers.pdf](#)

209.5 KB (PDF document)

Audiences

Insurance Managers Insurance Intermediaries

Guernsey Financial Services Commission

**Feedback and Final Consultation on
Professional Indemnity Insurance for Insurance
Intermediaries and Insurance Managers**

Issued 10 June 2022

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Background

On the 8 December 2021 the Commission published a consultation paper (“CP”) on professional indemnity insurance (“PII”). The Consultation period ran for 9 weeks until 14 February 2022.

There was a healthy response to the CP which saw 10 responses. Four of the respondents were intermediaries (two long-term, one combined long-term and general, and one general), four were insurance managers, one was an insurer and one was an industry consultant.

The CP is available on the [Consultation Hub](#).

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 Commission also considers it desirable for customers to have access to high quality insurance advice.

The purpose of the CP was to seek stakeholders' views on changes to the current PII rules to modernise them whilst ensuring both that customers are able to access high quality advice, and that they are also protected in the event of losses from poor quality advice.

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.

What is the Commission going to do next?

Alongside this feedback statement the Commission has issued a final draft 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.

The draft rules are attached for fatal flaw comments by 5 August 2022

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

Specific Feedback and Changes

1. £10,000,000 cap on the annual aggregate level of PII cover required

Respondents were generally supportive. A number noted that their turnover was not high enough for them to be affected. Two respondents commented that it was more important that a firm buy sufficient cover for the risks of the business and any cap would inevitably be somewhat arbitrary. One respondent questioned the benefit of a cap for clients. Several respondents felt a limit of £10,000,000 would make it easier to obtain cover.

2. Minimum cover for each and every loss increased to £1,000,000

There was a mixed response to increasing the individual loss limit to £1,000,000: some respondents supported it as a claim could easily exceed £250,000, particularly when legal fees are included. Other respondents felt that any increase would make it harder to buy

cover (although the research carried out before the CP indicated that all the firms in the survey currently bought £1,000,000 or more).

One correspondent felt that the each and every loss limit should be variable based upon the size of the business. The Commission recognises that this approach may appear more proportionate, however industry claims data does not show a strong correlation between firm size and claim size. Using size or other variables would also be difficult to manage and monitor.

Two respondents noted that each and every claim's limits were not standard across the market and may make obtaining cover harder. The Commission does not require firms to maintain limits for each and every claim. The purpose of the each and every loss limit section within the Rules is to ensure that firms, having arranged an appropriate amount of cover in the aggregate, do not then limit each and every loss within the aggregate to a small amount thus negating the benefit of cover. The Commission's preference is for firms to buy cover which has no individual claims' limits. Where firms choose to put in place individual limits, whether to increase availability of cover or reduce cost, then those limits must not be less than £1,000,000.

3. Firms are required to maintain PII cover which is consistent with size and nature of its business, and document that process

This proposal was agreed by all respondents, however there was some concern about how the Commission would determine whether the cover was consistent with the size and nature of a firm's business, particularly if reviewing the process with the benefit of hindsight.

The CP includes the proposal that firms must document the process for determining the level of PII that is appropriate for the size and nature of the business. As with any engagement following a supervisory event, a licensee's ability to demonstrate the suitability of its actions with thorough, contemporaneous documentation will assist it in demonstrating that its actions were appropriate.

4. The introduction of minimum policy terms and conditions

a. Cover for negligence, errors or omissions by the licensee or its employees

There were no comments.

b. Cover for any liability for the dishonest or fraudulent acts of employees which may fall on the licensee

One respondent commented that dishonest or fraudulent acts of employees may be covered by a policy other than professional indemnity insurance. The Commission has amended the rules to make it clear that this cover may be provided by a policy other than professional indemnity subject to it meeting the other requirements of the rules.

c. Cover for liabilities of its employees who, in the course of their duties to the licensee, perform functions in their own names

One respondent expressed concern about whether the proposed rules would make firms liable for the unauthorised actions of their employees. The purpose of this section is to

ensure that members of staff who take a role as part of their employment with the licensee but not in the licensee's name, for example being director of a charity the licensee is associated with, would also be covered for the advice given in that position. The Commission considers it important that where a third party might reasonably assume the employee is representing the licensee that appropriate cover is in place if that advice is relied upon.

d. Cover for liabilities which the licensee might incur in any jurisdiction in which it carries on business

This proposal was generally accepted although one respondent asked for clarification of the term “carries on business” in a jurisdiction. The Commission’s preference is that all firms buy cover on a worldwide basis as clients may travel or move. The Commission recognises, however, that this may not always be possible. As a minimum the Commission expects firms to have coverage for every territory in which they could reasonably expect to be subject to action in the event of negligence. For example, a general insurance broker arranging household insurance in Guernsey could reasonably expect to be held liable for negligence in Guernsey; an IFA advising a complex financial structure with connections to a large number of different jurisdictions should maintain a policy that includes all those jurisdictions.

e. Ombudsman awards

There were no comments.

f. Legal defence costs

Please see below.

g. Defence costs must not contribute to the aggregate limit

The Commission is concerned that legal costs are forming an increasingly large share of total claims costs. In the event that there is a large claim or series of smaller claims the available cover could be used up paying legal fees and there may not be sufficient funds left to indemnifying the clients who have suffered the loss.

The Commission’s proposal to protect the clients’ interests was to ensure that legal costs did not count towards the aggregate. This a requirement in some jurisdictions. However, the Commission has taken onboard the feedback from respondents that this cover is not universally available and would potentially limit even further the number of underwriters prepared to write this risk for Guernsey firms. The Commission is therefore not pursuing this proposal at this time.

h. Retroactive date from the date the firm was licensed

One respondent commented that underwriters may limit the retroactive date where the firm has changed in nature over the years and coverage has changed. The Commission considers that all firms should endeavour to secure cover from the date they are licensed to ensure that all clients are protected equally, however the Commission will retain the

ability to waive or amend this requirement in the event that it would be disproportionate and clients are not put at a materially increased risk.

5. Fee income

The Insurance Intermediaries Rules and the Insurance Managers Rules require that licensees maintain cover of “three times fee income”. The Consultation Paper did not consult on any changes to these requirements, however one of the purposes of the proposed changes is to introduce more consistency between the rules for different sectors in the financial services industry in Guernsey. The consultation on rules for the investment and fiduciary sectors is suggesting a clarification of their wording and it is proposed that a similar wording be used within the Insurance Intermediaries Rules and the Insurance Managers Rules.

It is proposed that the requirement for licensees going forward will be to maintain three times income from regulated activities, with an expectation that firms will consider arranging additional insurance if unregulated activities form a significant part of the firm’s business or is at greater risk of generating relevant insurance claims. As most firms in the insurance intermediary and manager sectors do not carry out any material unregulated activities this is not expected to have a significant impact on industry.

Guernsey Financial Services Commission

**Consultation Paper on Professional Indemnity Insurance
for Insurance Intermediaries and Insurance Managers**

December 2021

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Responses to this Consultation Paper are sought by 14th February 2022.

We welcome and encourage respondents to provide feedback or comment on any section and question. Feedback may be provided via the Consultation Hub section of the Commission's website (www.gfsc.gg).

Introduction

Purpose of the Consultation Paper

The Commission has been made aware by industry of an increasingly challenging Professional Indemnity Insurance (“PII”) market. Firms have found the availability of insurance reducing while prices are rising. The Commission has engaged with industry and other stakeholders through questionnaires and interviews. As a result of that engagement, the Commission is publishing this Consultation Paper to seek industry’s views on proposed changes to the rules around the maintenance of PII.

The Commission has engaged with the insurance sector and also the fiduciary and investment sectors. The issues surrounding price and availability are relevant for all sectors, but various factors differentiate the insurance industry from fiduciary and investment businesses. These factors include the exposure to retail customers; the location of customers; the nature of advice given within each sector; the average size of the firms; and each industry’s claims experience. The Commission is therefore carrying out a separate consultation for the insurance sector. Where appropriate the Commission has adopted consistent approaches across all industry sectors. A separate Consultation Paper making proposals in respect of PII for the fiduciary and investment sectors has also been published and is available on the Consultation Hub.

Summary of Proposals

The Consultation Paper proposes to loosen requirements where possible but also to ensure that the rules for PII are up to date and fit for purpose. A summary of the proposals in this consultation is provided at Appendix 1.

The Commission would like to thank the licensees which participated in the surveys and interviews for their cooperation.

Background

Professional indemnity insurance (“PII”)

PII “covers liability for injury, damage or financial loss arising from a breach of professional duty carried out in good faith or negligent acts, errors or omissions in their professional capacity. The persons covered by the policy include the insured, any employees/partners, any agent and any predecessors” (Chartered Insurance Institute).

PII indemnifies firms in the event that they provide poor advice or are negligent when looking after other’s assets. The cost of a claim combined with the legal expenses can be very large, often much greater than a firm’s net assets. PII ensures primarily that clients who have suffered loss will be compensated but also that the firm can continue to service other clients. Should the loss event itself cause such reputational damage to the firm that it cannot continue, insurance to cover the financial cost of the claim will allow for an orderly wind-down of the firm, subject to the claim being covered.

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 impose a requirement on certain financial services businesses that they maintain PII. This is consistent with supervisory regimes in other jurisdictions.

Licensees must continue to meet the relevant statutory Minimum Criteria for Licensing, which among other things require that business is conducted in a prudent manner. A licensee shall not be regarded as conducting their business in a prudent manner unless it maintains an appropriate amount of insurance cover.

PII does not prevent a negative event for clients but may limit their financial loss as result of it. It is therefore important that firms have PII that is of sufficient value and coverage to protect their customers and themselves.

Background to Changes in the PII Marketplace

The provision of PII has gone through significant changes in recent years at a market, regional and sector-specific level. This is partly as a result of general hardening of the insurance market but there have been particular issues reported for the PII sector such as historic under-pricing, significant losses in certain sectors and a reduced regulatory tolerance of loss-making insurers. The limited number of insurers offering cover for Guernsey firms together with a unique legal system; smaller firms generating lower premiums; and business models with different risks (relative to the UK) have added to the challenges in the Bailiwick’s PII marketplace.

It should also be noted that the difficulties obtaining PII are not limited to financial services.

Interaction with Industry

The Commission had been made aware of issues with obtaining PII cover by a number of insurance intermediary firms, particularly those doing long-term business. It was not clear whether this was a universal problem or specific to certain firms and, if the latter, why those particular firms. To obtain a better understanding of the issues the Commission engaged with general and long-term intermediaries in a number of ways:

- a high-level review when firms first experienced problems;
- a questionnaire when it became clear the issues were becoming more widespread; and
- a series of interviews with firms.

The data from the questionnaire and the feedback from the meetings with firms have been incorporated into the proposals within this paper.

Summary of findings from Questionnaire and Interviews

Both the general and long-term intermediary sectors are relatively small. It is not possible to publish in detail the data obtained from the questionnaire and interviews without extrapolating information about individual licensees. On that basis, any observations on the outcomes of the questionnaire and interviews are limited to high level comments.

Premium Increases

The questionnaire assessed premium movements over the period 2016 to 2020. Most of the increases have taken place since 2018 although some firms saw increases before then. At one extreme a small number of firms have seen rises over the period of up to 300%, while others have seen a fall in premium costs over that period. Premiums can be affected by a number of factors including growth or contraction of a firm, underlying business model and claims history. However, from the information provided, on average across the whole insurance intermediary sector premiums rose by approximately 80% between 2016 and 2021 and now represent between 2% and 6% of turnover for the majority of firms.

The background to the changes in the PII market have been noted above. Discussions with industry identified a number of factors which particularly effect individual insurance intermediaries in Guernsey:

- firms whose insurers have remained in the market have benefitted from long term relationships;
- firms whose insurers have reduced or withdrawn cover have often found it difficult and/or expensive to replace cover;
- firms need to begin renewal discussions with the market much earlier; and
- claims history and premium increases are not strongly correlated.

Claims History

The questionnaire responses confirmed that there have not been a large number of PII claims against the insurance intermediary market. Where claims have occurred, their size has varied greatly. The Commission noted that a significant portion of claims costs are legal fees and a

number of cases generated large legal fees despite the claim being settled in favour of the intermediary.

Proposed Changes

Scope of Proposals

The requirements for firms to maintain PII come from the Insurance Intermediaries Rules and the Insurance Managers Rules.

The Insurance Intermediaries Rules apply PII requirements to all licensees. The PII requirements in the Insurance Managers Rules apply only to an insurance manager who advises or arranges insurance products in relation to the general public and is required to appoint an authorised insurance representative, which includes any individual authorised by a licensee as a financial adviser.

Any changes to PII requirements will apply to both the Insurance Intermediaries Rules and the Insurance Managers Rules; together these rules are referred to as “the Insurance Rules”.

The Commission considered lowering the requirement for PII to align with the UK; that is a cap of EUR 1,900,000. However, the Commission has decided against this. This is because such an approach would materially lower the level of coverage for several firms, because there is no equivalent to the UK Financial Services Compensation Scheme in Guernsey and because, while the market remains hard, upward pressures on access to PII under the current requirements appear to be showing some signs of easing.

Nevertheless, the Commission suggest below that the current requirement be capped. It also suggests that some aspects of industry good practice around PII should be formalised in rules.

Cap on the level of PII cover required under the Insurance Rules.

The amount of cover required under the Insurance Rules is “on an annual basis, £1,000,000 or three times fee income, whichever is the greater” [Insurance Managers Rules 7.5 (1)(b); Insurance Intermediaries Rules 7.8.1 (1)(b)].

There is no limit to the amount of annual cover required under the current rules. This is inconsistent with the requirements in other Crown Dependencies where a number of Guernsey firms also have a presence. Jersey and the Isle of Man regulate insurance intermediaries differently to Guernsey but they generally apply a £10,000,000 cap on annual cover. The survey of licensees indicated that this would be sufficient to cover historic claims.

It is proposed that the Insurance Rules be amended to so that the amount of annual cover required is capped at £10,000,000. This proposal is also included within the fiduciary and investment consultation. It will make Guernsey more consistent with the other Crown Dependencies and should remove a barrier to obtaining cover, while not being likely to cause any material detriment to customers of insurance intermediaries.

Q1: Do you have any comments on the proposal to introduce a cap of £10,000,000 on the annual level of PII cover required by the Insurance Rules?

Q2: Do you consider that a cap should be for a different amount than £10,000,000, or there should be no cap? Please explain why.

Minimum Cover Each and Every Loss

The Insurance Rules currently require that firms must maintain PII cover of at least £250,000 each and every loss. This is a historic figure and lower than in other jurisdictions where a minimum of £1,000,000 each and every loss is common. The survey indicated that, in practice, all firms are buying each and every loss cover of at least £1,000,000. The claims history of the insurance intermediary sector indicates that there are claims above £250,000 and the Commission considers £1,000,000 to be a more appropriate minimum level of cover.

All firms are already maintaining cover of £1,000,000 each and every loss and therefore this proposal should have no material effect on industry.

Q3: Do you have any comment regarding the proposal to increase the minimum cover for each and every loss to £1,000,000?

Requirement for a Firm to Determine its Minimum Level of Cover

The purchase of PII is an important part of a firm's risk mitigation and the Board or management committee is expected to give consideration to the level required based on the size and nature of the business as part of its governance process. The Commission is aware that most Boards or management committees already give considerable thought to the amount of cover they purchase and the terms and conditions of the policy.

To ensure that all firms consider their PII arrangements the Commission is proposing to introduce a requirement that firms must maintain a breadth of PII cover and an amount, for each claim and in the aggregate, which is commensurate with the size and nature of the business. Firms must also document this decision-making process. Should a firm identify that it needs greater cover than that required by the Insurance Rules then it would be required to maintain that higher level of cover.

Q4: Do you have any comment regarding the proposal that a firm should be required to maintain PII cover which is consistent with size and nature of its business, and document that process, irrespective of any other regulatory requirements?

Minimum Policy Terms and Conditions

The Insurance Rules do not currently specify what terms or conditions a PII policy must contain: insurers are free to choose which terms to offer and firms are free to choose which terms to accept. The Commission is aware that the terms and conditions offered will vary over time and by the nature of the insured. There is a risk, however, that intermediaries will buy the minimum coverage possible, either because of availability or price, and this will reduce its effectiveness in protecting customers interests.

Rules regarding PII issued by the Commission for other financial sectors in Guernsey contain some requirements about minimum terms and conditions, and they are common in other jurisdictions. The Commission wishes to introduce greater consistency across Guernsey firms whilst recognising that there will be variations across sectors. It is therefore proposed that all rules issued by the Commission in respect of PII policies will require firms to maintain certain core minimum terms and conditions.

The minimum terms and conditions that are proposed to be included in the Insurance Rules are:

1. Cover for –
 - a) negligence, errors or omissions by the licensee or its employees;
 - b) any liability for the dishonest or fraudulent acts of employees which may fall on the licensee;

- c) liabilities of its employees who, in the course of their duties to the licensee, perform functions in their own names;
 - d) liabilities which the licensee might incur in any jurisdiction in which it carries on business;
 - e) ombudsman awards; and
 - f) legal defence costs.
2. Defence costs must not contribute to the individual loss or aggregate limit.
 3. Retroactive date from the date the firm was licensed.

The minimum terms and conditions have been identified by the Commission as common to PII policies and these proposals should not materially affect the policies maintained by insurance intermediaries. The minimum proposed terms are equivalent to or less than is required in many other jurisdictions and the Commission would welcome suggestions on whether there should be additional requirements.

Firms will be expected to continue to arrange cover which is appropriate for the size and nature of their business, not just the minimum proposed for the Insurance Rules.

Q5: Do you have any comment regarding the proposed minimum policy terms and conditions?

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Appendix 1

Comparison of Current Requirements with Proposed New Requirements:

Current	Proposed
1. Minimum Cover per Annum £1,000,000 or three times fee income, whichever is the greater	£1,000,000 or three times fee income, whichever is the greater subject to a maximum of £10,000,000
2. Minimum Cover for Each and Every Loss Limit £250,000	£1,000,000
3. Excess Where the deductible or excess exceeds £20,000 on the basis of each and every loss, the minimum capital requirement will increase to 125% of the deductible or excess.	No change
4. Cover Should be Maintained to the Level Determined by the Board/Management Committee No requirements	A firm will maintain PII cover which is consistent with size and nature of its business, and document that process, irrespective of any other regulatory requirements.
5. Minimum Terms and Conditions No requirements	<ol style="list-style-type: none"> 1. Cover for – <ol style="list-style-type: none"> a) negligence, errors or omissions by the licensee or its employees; b) any liability for the dishonest or fraudulent acts of employees which may fall on the licensee; c) liabilities of its employees who, in the course of their duties to the licensee, perform functions in their own names; d) liabilities which the licensee might incur in any jurisdiction in which it carries on business; e) ombudsman awards; and f) legal defence costs. 2. Defence costs must not contribute to the individual loss or aggregate limit. 3. Retroactive date from the date the firm was licensed.