

# **Professional Indemnity Insurance and Retail Intermediaries**

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# Agenda



- The make-up of the retail intermediary sector
- Current trends, issues and risks
- Review of prudential requirements for Personal Investment Firms
- Questions.

## PI for Personal Investment Firms:

- A niche market!
- GWP £50 million in 2007
- 5% of total UK PI GWP
- 10 -15 core players
- Cost: 1.0 - 1.5% of revenue.

Source: Frontier Economics – Market study of PI Insurance for PIFs. April 2008.

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# Make-up of the sector

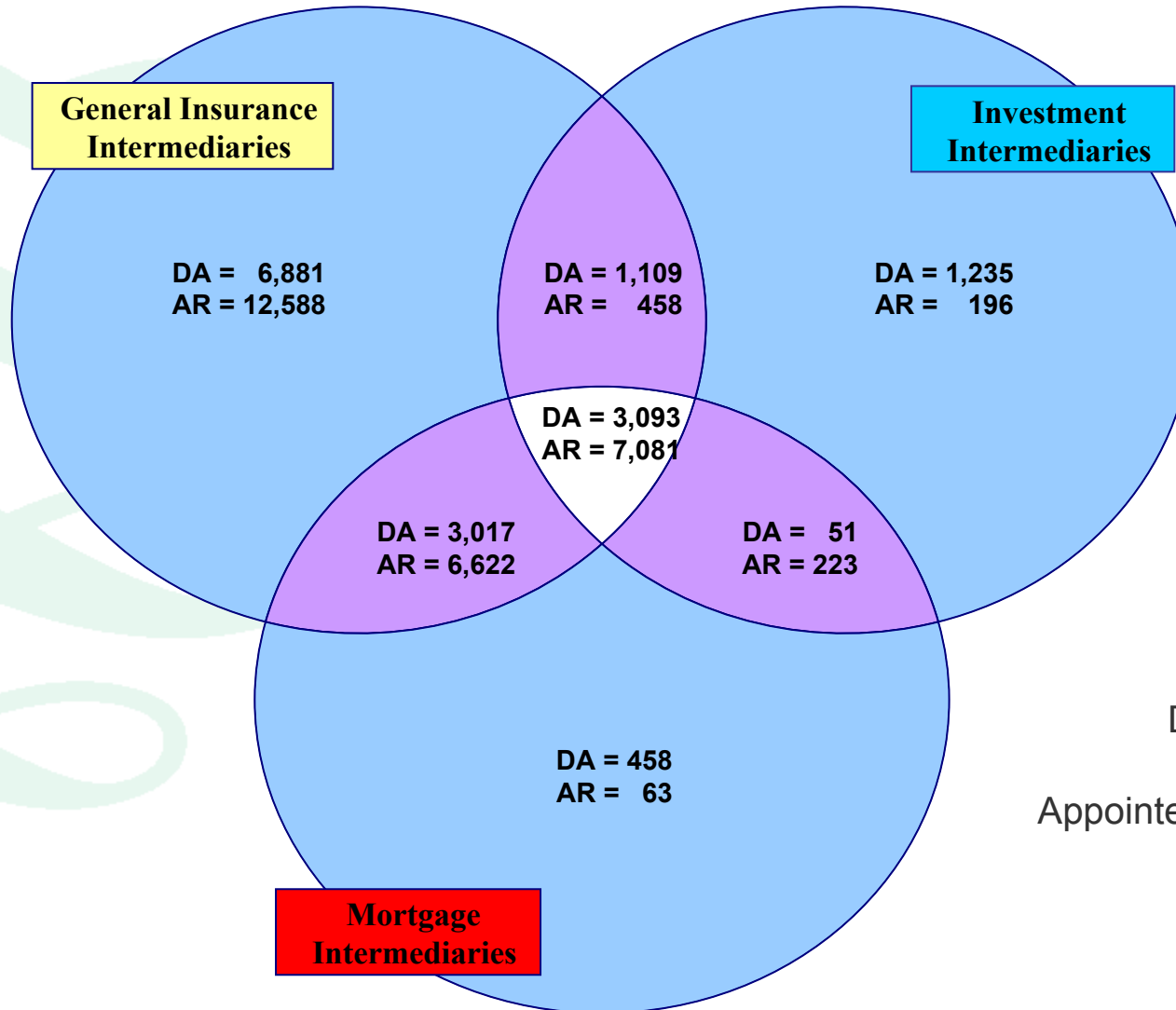


Divided into three sub-sectors:

- Financial adviser firms
- Mortgage Intermediaries
- General Insurance Intermediary firms –  
Primary and Secondary.

# Make-up of the sector

Sector population as at 1st May 2008:



## TOTAL POPULATION

Directly Authorised (DA)  
= 15,844

Appointed Representatives (AR)  
= 27,231

# Make-up of the sector



## Minimum limits of Indemnity:

- Firms within the scope of the Insurance Mediation Directive (IMD):
  - €1 million for a single claim
  - €1.5 million in aggregate
  - Maximum level of excess applies
  
- Full requirements are detailed in our Handbook (MIPRU & IPRU-Inv).

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# Current trends, issues and risks



## FSA Statutory Objectives:

- Market Confidence
- Public Awareness
- Consumer Protection
- Reduction of Financial Crime.

# Current trends, issues and risks



Financial Risk Outlook 2008 - key challenges for retail intermediaries:

- Adapting business models to cope with less benign financial conditions
- Improving management and oversight
- Improving the quality of advice.

# Current trends, issues and risks

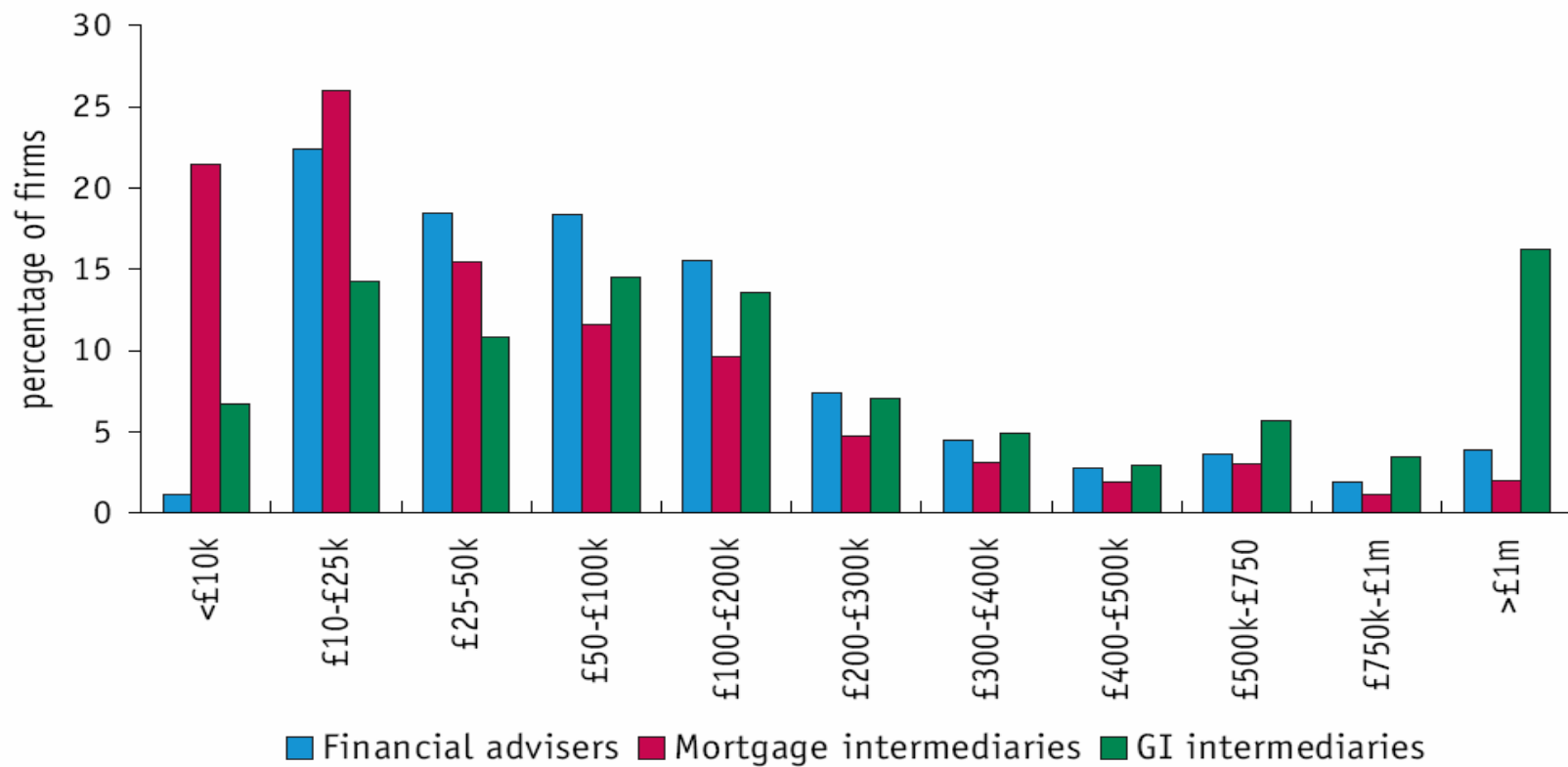


Adapting business models to cope with less benign financial conditions:

- Do firms have sufficient financial resources (including PI cover) to cope?
  - In the event of a reduction in business
  - To meet the costs of any increase in complaints.

# Current trends, issues and risks

Chart C8: Regulatory capital in retail intermediary firms



Source: FSA

# Current trends, issues and risks



Adapting business models to cope with less benign financial conditions:

- Mergers and acquisitions
- Transition to a recurring income model
- Diversification

Maintaining income whilst remaining compliant and treating customers fairly is a key challenge.

# Current trends, issues and risks



## Improving management and oversight:

- Of interest to PI Insurers as well as the FSA
- Control and monitoring of AR's of particular concern
- Ultimate responsibility for compliance cannot be outsourced
- The impact of exercises to reduce operating costs.

# Current trends, issues and risks

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Improving management and oversight -  
financial crime prevention:

- Information security – identity fraud
- Anti-Money laundering
- Mortgage fraud.

# Current trends, issues and risks

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## Improving the quality of advice:

- Collecting sufficient information to:
  - Establish needs
  - Assess affordability
  - Assess attitude to investment risk
- Training and competence
- Communications with customers.



# Agenda

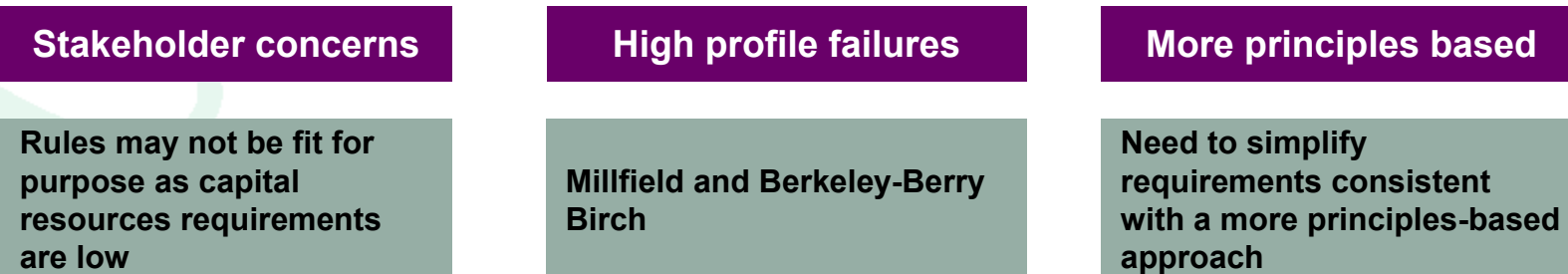


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# Background to the review



## The need for the review



# Review of prudential requirements



Discussion Paper 07/4 - published July 2007:

- Early thinking on potential changes to the prudential rules for Personal Investment Firms, and to industry practice
- ...to mitigate better the market failures in the sector.

# Review of prudential requirements

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## Desired outcomes:

- Reduce the frequency of mis-selling
- Reduce the impact of mis-selling
- Mitigate the impact of latent liabilities
- Enable firms to wind down in an orderly manner.

# Review of prudential requirements



## Associated work:

- Study by Europe Economics on predictors of loss
- Study of capital held by firms
- **A PI market study by Frontier Economics.**

# PI market study



## To understand better:

- Problems related to the provision of PII
- Approaches to underwriting
- Implications of writing cover on claims-made basis
- Appropriate mechanisms to leave resources behind.

# PI market study



## And help us consider if changes might:

- Create additional incentives for firms to provide good advice
- Move the burden of unsuitable advice claims onto those that create them
- Reduce the claims burden on the Financial Services Compensation Scheme
- Enhance competition between insurers.

# PI market study



## PI Policy Options explored:

1. Changing prescribed maximum excess levels
2. Reviewing the specified additional capital levels
3. Limiting the scope of permitted exclusions
4. Imposing a cap on total excess payments
5. Scope for changing approaches to underwriting
6. Business-written
7. Requirement for run-off cover
8. Reviewing the comparable guarantee option
9. The adequacy of indemnity limits.



# PI market study



## Frontier's findings:

- Most claims related to a small number of products
- No current market failures in the PI market for Personal Investment Firms
- No evidence of a lack of competition in the provision of PI to these firms
- No evidence to suggest this segment of the PI market was more profitable than other lines
- The way PI is provided has no significant impact on firm's conduct.

## Frontier's findings – policy options:

- No evidence that current PI requirements are not fit for purpose
  - Amendments to existing “claims-made” regulations unlikely to yield material net benefits
  - Business-written would create benefits, but...
  - Further consideration required on run-off cover
  - No evidence that changing the definition of comparable guarantee or indemnity levels would deliver material net benefits.

## Our response to the findings:

- The findings, in conjunction with individual responses to the DP, suggest that there is no need for significant changes to existing rules
- On-going activity to reduce instances of large spikes in claims
- Further work on leaving resources behind.

# Review of prudential requirements



## Next steps:

- Limited scope to use prudential rules to mitigate the frequency of mis-selling - More scope to reduce the impact
- Consider the wider picture (requirements include capital as well as PI)
  - Need for level playing field
  - Need for simplification
  - Need for consistency
- Undertaking further work on leaving resources behind
- Plan to consult on any proposed changes in Q4.

# Questions.

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