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.

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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:

- **General Insurance Intermediaries**
  - DA = 6,881
  - AR = 12,588

- **Investment Intermediaries**
  - DA = 1,109
  - AR = 458

- **Mortgage Intermediaries**
  - DA = 3,093
  - AR = 7,081

- **Total Population**
  - Directly Authorised (DA) = 15,844
  - Appointed Representatives (AR) = 27,231
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.
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.
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
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

Improving management and oversight - financial crime prevention:

- Information security – identity fraud
- Anti-Money laundering
- Mortgage fraud.
Improving the quality of advice:

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

Scope

Firms

Personal Investment Firms (PIFs) not covered by MiFID

Rules

Capital Resource Requirements

Professional Indemnity Insurance (PII)

The need for the review

Stakeholder concerns

Rules may not be fit for purpose as capital resources requirements are low

High profile failures

Millfield and Berkeley-Berry Birch

More principles based

Need to simplify requirements consistent with a more principles-based approach
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

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.
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
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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