

Legal and Regulatory Challenges to PI Insurance

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Impact of Regulation on PI



Looking at 3 topical issues:

- UK Government - FSA
- EU - New Directive
- Legal Decision - Impacting a market wording

The FSA - What have they done for us?



Three Pronged

- Regulation
- The hornet's nest
- Opportunities

FSA

Regulation of the Insurance Market



Insurance needs regulation

- Independent collapse
- Losses caused by “the spiral”
- Consumers need confidence in us
- We take on the risk of others so need to manage our own risk

The result of FSA regulation

- Compliance departments springing up everywhere
- Underwriting Licences
- Training Licences
- Interviewing Licences

Regulation of the Insurance Market

All this should mean:

- More care taken in underwriting
- Risks adequately assessed and rated (risk capital)
- Fewer “rogue” quotes
- Clearer documentation e.g. quotations, wordings etc
- Greater security for the Insured

How is it so far?

FSA

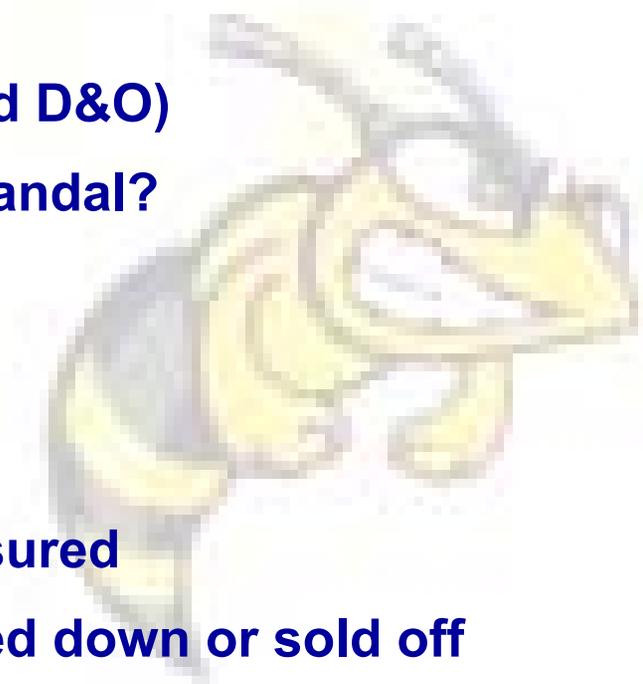
The Hornet's nest

Don't have to look too far

- Pensions
- Endowments
- Split Caps (PI and D&O)
- Next financial scandal?

Result?

- Restricted cover
- Many firms uninsured
- Other firms closed down or sold off



The opportunity

Secondary Intermediaries need PI cover

Limit at least €1m per claim and the greater of

- €1.5m or
- 10% of income in the aggregate up to €30m

Excess no more than:

- £5,000 or 3% of income if holding client money or
- £2,500 or 1.5% of income if not holding client money

Must cover:

- Activities of employees and appointed representatives
- Defence costs
- Activities undertaken from date of authorisation
- Ombudsman awards

The opportunity

PI Market reaction

- First thought - don't want to cover Arthur Daley!!
- The FSA regime gives underwriters comfort
- If can get through the application process then "should be good risks"

Result

- A number of insurers now have products
- Premiums range from £150 to £1,000's

Problem?

- Cover being given now - what if they don't get authorisation?
 - Do we cancel?
 - Charge time on risk?
 - Cancel from inception?

The EU - Proposed legislation

Proposal For A Directive On Services In The Internal Market

- Intended to cut red tape
- Removing legal and administrative barriers to service activities between member states

Areas covered

- all services except where already specific initiatives (i.e. Financial Services, telecoms, transport)
- where they are
 - Provided at a distance (e.g. internet, phone etc.)
 - Present in country where provided (temporary or permanent)
 - Customer travels to them – e.g. hotels
 - Covers 60% of employment in EU

In place by 2008

The EU - Proposed legislation

Article 27 Professional Insurance and Guarantees

“Member States shall ensure that providers whose services present a particular risk to the health or safety of or a particular financial risk to the recipient are covered by appropriate professional indemnity insurance”

“Member States may not require professional insurance or a financial guarantee from the provider where he is already covered by a guarantee which is equivalent, or essentially comparable as regards its purpose, in another Member State in which the provider is already established. Where equivalence is only partial, Member States may require a supplementary guarantee to cover those aspects not already covered.”

The EU - Proposed legislation

Article 27 - Makes Professional Indemnity cover compulsory

- EU do not propose laying down minimum standards
- Will leave it to governments and professional bodies
- However - where they see inaction they will enforce
 - Example given was construction and medical sectors



The EU - Proposed legislation

Article 27 - Impact on the Insurance market?

- **First impression - opportunity for new business**

BUT

- **Liability Laws differ through the EU**
 - **UK discovery up to 15 years**
 - **Greece off the hook after 6 months!!**
 - **Germany has the potential for 30 years**
- **Policy coverage vastly different**
- **Basis of cover**
 - **from Claims Made in UK**
 - **to “Acts Committed” in Germany and Austria**
 - **with discovery periods on top of Claims Made in others**

The EU - Proposed legislation

Article 27 - Will it have the desired effect?

- **Potential cost may mean it is not purchased and people trade illegally or close down**
- **Cover purchased in “Home Country” for the whole of the EU**
 - **Will insurers want to underwrite covers?**
 - **Will they have the knowledge to do so?**
 - **Who decides if home cover is “equivalent”?**
- **Does taking out PI insurance actually improve consumer protection and cut red tape?**
 - **Medical errors will still be made**
 - **Not all PI policies cover injury claims**
 - **A policy in place may lead to complacency**
 - **What red tape will be involved in checking if cover in place?**

The EU - Proposed legislation

Article 14 - Prohibited Requirements

“Member States shall not subject access to or the exercise of a service activity on their territory to compliance with any of the following requirements:”

These include:

“7. an obligation to provide or participate in a financial guarantee or to take out insurance from a service-provider or body established on their territory;”

The EU - Proposed legislation

Article 14 - Impact

Compulsory master policies or mutuals may not be allowed

- There are a few in the professions
 - Northern Ireland and Scottish Solicitors
 - Barristers
- Could lead to increased prices or reduced coverage



The EU - Proposed legislation

Article 16 - Country of origin principle

“Member States may not....restrict the freedom to provide services supplied by a provider established in another Member State, in particular, by imposing the following requirements:”

These include:

“an obligation on the provider to make a declaration or notification to, or to obtain an authorisation from, their competent authorities, including entry on a register or registration with a professional body or association on their territory;”

The EU - Proposed legislation

Article 16 - Impact

- Will this mean professional bodies cannot regulate activities?
- Will it mean an inferior PI policy having to be accepted?
- Is this in the consumers interest?



The EU - Proposed legislation

This proposal has the potential to impact on all of us

■ **What can we do?**

- **Only a draft**
- **Some interested parties have already responded**
- **Professional bodies should take a close look**



Legal Decision - and a market wording

Quick overview of Lords decision in *Lloyds TSB* case

- Were all pensions claims aggregated or separate claims?
- Series clause was held to have a narrow construction
- Decision was that they were separate claims
- Result - deductible (£10m) applied to each claim - no payment by Insurers

Would seem to have gone in insurers favour, but.....

- Normal level of deductible means increased sideways spread
- Some matters previously thought to aggregate may no longer
 - e.g. Dishonest acts committed over time

Legal Decision - and a market wording

Similarities between Series clauses in Lloyds TSB and Law Society Minimum Terms

- Insurers powerless to change
 - Feel the goalposts have been moved
 - On other professions series clause can reflect intentions

Law Society recognise that “any one claim” definition now narrower (in certain circumstances)

- Meetings were held
- Qualifying Insurers suggested a revised wording
- Law Society rejected the change
 - Insufficient time for 2004 renewal
 - Need to consider implications
 - Could lead to higher compulsory limit
 - Suggest Insurers can use other means to limit impact

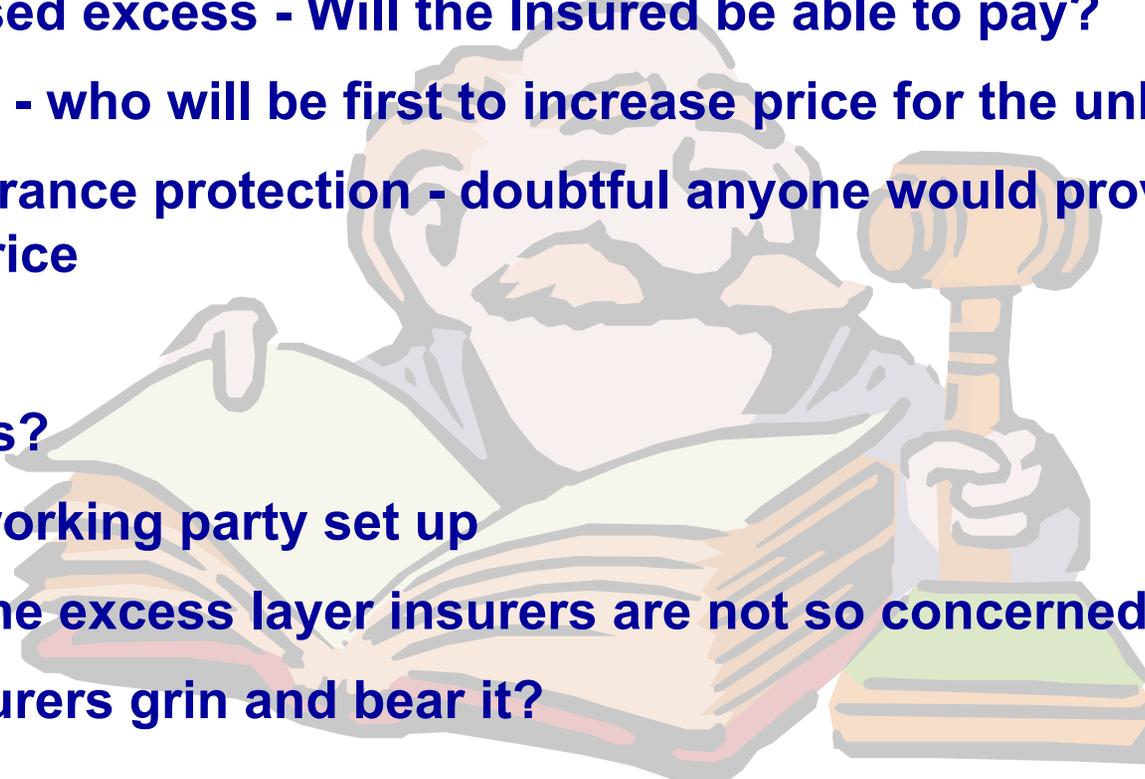
Legal Decision - and a market wording

Law Society suggested could be dealt with by:

- Increased excess - Will the Insured be able to pay?
- Pricing - who will be first to increase price for the unknown?
- Reinsurance protection - doubtful anyone would provide at right price

Next steps?

- Joint working party set up
- Presume excess layer insurers are not so concerned
- Do insurers grin and bear it?



Legal Decision - and a market wording

Could the goalposts move again?



Legal Decision - and a market wording

Or will we all blame the spot?



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Questions