

Claims Management Regulation - Professional Indemnity Insurance

Consultation Paper

CP 04/07

23/02/2007

This consultation will end on 25/05/2007

Claims Management Regulation

Professional Indemnity Insurance

**A consultation produced by the Department for Constitutional Affairs.
This information is also available on the DCA website at www.dca.gov.uk**

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Executive summary

Businesses that provide claims management services must be authorised under the provisions of the Compensation Act 2006. The act allows the Regulator to make rules in respect of professional indemnity insurance. In the consultation on the Rules of Conduct for authorised businesses it was accepted that while Professional Indemnity (PI) insurance was desirable the requirement could not be introduced immediately as some businesses would have difficulty obtaining cover.

PI insurance would help to protect consumers who might otherwise suffer loss in the event that an authorised business was unable to meet its liabilities. However, PI insurance cannot protect consumers in all circumstances, and it is costly for businesses. The premium may be around 1% of turnover compared with regulatory fees of under 0.4%.

There is no strong case for requiring businesses that do not have a contract with clients to have PI insurance. For those businesses that do, the proposal is to replicate the Financial Services Authority's requirement in respect of general insurance intermediaries. The following requirements are put forward for consultation -

- (a) Authorised businesses that have contracts with client, whether or not they represent clients, should be required to have PI insurance.
- (b) Cover should provide for individual claims up to £650,000 with an aggregate limit of £1 million or 10% of annual income if higher.
- (c) The excess should be not more than the higher of £5,000 or 3.0% of annual income.
- (d) The requirements should apply from 1 January 2008.

A draft of the proposed Rules is included in this consultation document.

Introduction

This paper sets out for consultation the draft rules on Professional Indemnity Insurance. The consultation is aimed at those with an interest in claims management in England and Wales.

This consultation is being conducted in line with the Code of Practice on Consultation issued by the Cabinet Office and falls within the scope of the Code. The Consultation Criteria, which are set out on page 22, have been followed.

We produced a comprehensive full Regulatory Impact Assessment (RIA) (see <http://www.dca.gov.uk/legist/compensation.pdf>) to accompany the Compensation Bill. The RIA covered the impact of the regulations to be made under the primary legislation. We would be happy to discuss any regulatory impact issues arising as a result of the proposed legislation.

Copies of the consultation paper are being sent to those named below. However, this list is not meant to be exhaustive or exclusive and responses are welcomed from anyone with an interest in or views on the subject covered by this paper.

Government Departments

1. Department for Trade & Industry
2. Her Majesty's Treasury
3. Department for Work & Pensions

MPs and Peers

4. MPs and Peers who spoke during the Compensation Act and secondary legislation debates
5. Members of the Constitutional Affairs Select Committee

Regulatory Consultative Group

6. Advertising Standards Authority
7. Association of British Insurers
8. Association of Independent Financial Advisers
9. Association of Personal Injury Lawyers
10. British Insurance Brokers' Association
11. Citizens Advice Bureau
12. Claims Standards Council
13. Financial Ombudsman Service
14. Financial Services Authority
15. Forum of Insurance Lawyers
16. Law Society
17. Legal Expenses Insurance Group
18. Motor Accident Solicitors Society
19. Office of Fair Trading
20. Solicitors Regulation Authority
21. Trades Union Congress
22. Which?

Claims Management Businesses

23. Claims Management Businesses for which the DCA Monitoring & Compliance Unit have contact details (a list of authorised businesses is available on the claims management regulation website: www.claimsregulation.gov.uk)

The proposals

1. The Government recognises that many consumers have not had a fair deal when using the services of intermediaries to claim compensation. Part 2 of the Compensation Act, which received Royal Assent in July 2006, establishes a statutory framework for the regulation of claims management services.
2. The main regulatory arrangements have been brought into effect, all the secondary legislation has been approved by Parliament, and the Regulator's rules have been published. Businesses have been able to apply for authorisation from November 2006 and if authorised will have to comply with strict rules of conduct. This code covers advertising and marketing, taking on business, representing a client, handling client money and handling complaints. It is expected that it will be an offence to provide claims management services without authorisation or exemption from April 2007.
3. Businesses that provide claims management services must be authorised under the provisions of the Act. Regulated services are defined as –
 - (a) advertising for, or otherwise seeking out (for example, by canvassing or direct marketing), persons who may have a cause of action;
 - (b) advising a claimant or potential claimant in relation to his claim or cause of action;
 - (c) referring details of a claim or claimant, or a cause of action or potential claimant, to another person, including a person having the right to conduct litigation, but not where this is not undertaken for or in expectation of a fee, gain or reward;
 - (d) investigating, or commissioning the investigation of, the circumstances, merits or foundation of a claim, with a view to the use of the results in pursuing the claim;
 - (e) representation of a claimant (whether in writing or orally, and regardless of the tribunal, body or person to or before which or whom the representation is made).
4. Claims in the following six sectors are covered –
 - (a) Personal injury, including work-related injury, disease or disability.

- (b) Criminal injury compensation.
 - (c) Industrial injury disablement benefit.
 - (d) Employment.
 - (e) Housing disrepair.
 - (f) Financial products and services.
5. The rules of conduct (available on the website www.claimsregulation.gov.uk) identify two categories of business for which additional rules apply -
- (a) where the business has a contractual relationship with the client
 - (b) where the business represents the client

Category (b) is a subset of category (a). Businesses providing services in the personal injury field will seldom, if ever, “represent the client” as this will be done by a solicitor.

6. It should be noted that where client money is held then this must be in accordance with prescribed client account rules, which are modelled on those of the Council for Licensed Conveyancers.

The requirement to have Professional Indemnity (PI) insurance

7. Section 9 of the Compensation Act 2006 empowers the Secretary of State to make Regulations about authorisations. Paragraph 11 of the Schedule to the Act provides –
- “11 (1) Regulations may require, or permit the Regulator to require, an authorised person to take out a policy of professional indemnity insurance in respect of his actions in the course of providing or purporting to provide regulated claims management services.
- (2) Regulations under sub-paragraph (1) may, in particular—
- (a) make provision about the level or nature of insurance cover to be provided by the policy;
 - (b) include provision about failure to comply (which may, in particular, provide for compliance to be treated as a condition of authorisations or enable the Regulator to impose conditions on, suspend or cancel authorisations).”
8. Paragraph 21 of the Regulations provides -

“The Regulator may, by written notice, require an authorised person to take out a policy of professional indemnity insurance in accordance with specified

conditions in respect of the person's activities in providing regulated claims management services."

9. Paragraph 7 of the Rules of Conduct provides –

"A business shall maintain professional indemnity insurance in accordance with any rules made by the Regulator. (There are currently no additional rules but it is expected that rules will be consulted on and made by summer 2007.)"

10. Professional Indemnity insurance was covered in the consultation on the rules of conduct DCA CP(L) 12/06. The following is reproduced from the Summary of responses to the DCA's consultations on claims management regulation (CP(R) 12, 18, 22 and 22A/06)

"Question 6: Should holding professional indemnity insurance be a requirement for authorisation? Would it be possible in practice for authorised businesses to obtain such insurance from the outset or should requirements be phased in to allow sufficient time for a market to develop?"

Summary of responses

This question is closely related to question 8 of the consultation on the draft regulations considered above, and therefore provoked similar responses. There was general acceptance of the need for authorised businesses to have professional indemnity insurance. However, it was also noted that it might not be easy for all businesses to obtain such insurance at short notice.

Conclusions

As outlined above, the need for professional indemnity insurance is accepted. However, there is a question as to whether all businesses should be required to have insurance or whether, for example, this should not be a requirement for introducers.

It would be unreasonable to impose a requirement for PI cover immediately. Some businesses may find it difficult to obtain cover and at the least such a requirement would delay the authorisation process.

The DCA will consider requirements for professional indemnity cover. There will be full consultation before the requirements are introduced, which will be in 2007/08."

Timetable

11. The planned timetable is -

- 25 May 2007: closing date for responses to consultation.
- June 2007: rules published.
- 1 January 2008: rules come into force.

Should Professional Indemnity (PI) insurance be required?

12. It is a common requirement of regulatory systems for regulated businesses to carry a prescribed amount of professional indemnity insurance. The purpose of PI cover is to protect consumers who might otherwise suffer loss in the event of an authorised business being unable to meet its liabilities. A useful additional benefit is that PI insurers will wish to satisfy themselves that the business is run in such a way as to minimise the chance of a claim being made. These risk assessments allow insurers to price according to risk, which encourages businesses to manage their risk better.

13. However, imposing a PI requirement also has costs, limitations and disadvantages:

- There is an additional cost imposed by regulation on those businesses that would otherwise not have PI insurance. Typically this cost is higher than the licensing or authorisation fees.
- PI insurance will not protect consumers in all circumstances; there are limits on cover and circumstances in which a policy can be invalidated.
- Small businesses in particular may not be able to obtain PI cover or be able to do so only at considerable cost in terms of premiums or changes to the way that they conduct business. They may be forced to leave the market, or risk operating in breach of their statutory obligations. And a PI requirement can be a significant barrier to entry.
- Some businesses may be required to pay for PI insurance but their business model might be such that they could never make a claim.

14. The price of PI insurance is therefore a key factor. It is useful to bear in mind that the annual fee for authorisation is on a scale from 0.386% of turnover up to £1 million, falling to 0.24% of turnover over £5 million but with a minimum fee if £400.

15. The best comparator for claims management businesses are insurance brokers. It is understood that PI premiums are typically around 0.3% of turnover. However, the market is considered to be “soft”; a few years ago premiums at the smaller end of the market were as high as 7%. Soundings in the industry suggest that small claims management businesses may have to pay premiums of around 1% of turnover.
16. “Level playing field” issues and the requirements of other regulators need to be borne in mind. Here it is necessary to distinguish the three separate categories of business identified in the rules of conduct –
 - Introducers. Where referring cases is incidental to a business’s main activity and fewer than 25 cases a quarter are referred, then a business is exempt from the need to be authorised; however the person they are introducing business to must ensure that they comply with the rules of conduct. Other introducers need to be authorised in their own right.
 - Those with a contract with clients.
 - Those with a contract with clients and that also represent clients, particularly in endowment and criminal injuries compensation claims. Most, but not all, of this group hold client money.
17. It is also necessary to distinguish types of claims management business –
 - Specialist businesses.
 - Business where claims management follows on from other activities, such as insurance broking or accident management.
18. Currently all insurance brokers and IFAs are required to have PI cover in respect of regulated activities
19. Most claims management businesses are not currently required to have PI cover because of other business activities – the big majority are **specialist claims management companies**; the second most common category is accident management business.
20. The current position leads to two conclusions –
 - There is no strong case for those businesses that merely refer cases to be required to have PI cover. Many such businesses are very small and in

most cases do no more than refer cases to claims management businesses or to solicitors. They do not give advice or represent the client, and do not take any payment from the client. It is difficult to envisage the circumstances in which a person could claim against such an introducer, and if they did how PI insurance might be relevant. Also, such a requirement cannot be imposed on exempt introducers and it would be unreasonable to introduce what would be a significant additional cost that would have to be borne by introducers that referred say 30 cases a quarter rather than 20 cases a quarter.

- There is a stronger case for requiring those businesses that represent clients to have PI insurance. In practice, with a few exceptions, businesses dealing with personal injury claims do not represent the client, but businesses in the other sectors do. The work they are doing is analogous to that of solicitors, insurance brokers and IFAs. If they give bad advice or represent their clients ineffectively then they could cause their clients loss. A number of businesses in this category already have PI cover, indicating that cover is, at least to a certain extent, available in the marketplace.

21. The position in respect of businesses that have contracts with clients but which do not represent them is between these two positions. There is a relatively small number of such companies, mainly in the personal injury market but also in some of the other markets. These businesses typically refer cases to solicitors; they may arrange ATE (After the Event) insurance and possibly loan finance. To some extent they “own” the client. In practice they give advice. For example, they may advise on whether a case should be pursued and they may advise on how it should be pursued. It is among this type of businesses that there has been significant malpractice in the past. The responses to the consultation on the Rules of Conduct included a number that suggested that this group of businesses should be required to have PI insurance.

Question 1: Is it accepted that those businesses that are only introducers should not be required to have PI insurance?

Question 2: Should businesses that represent clients have PI insurance?

Question 3: Should businesses that have contracts with clients but do not represent them have PI insurance?

What PI insurance should be required?

22. Wherever possible the DCA has replicated requirements of other regulators, partly to be able to use tried and tested procedures and partly because these will be familiar to some of those in the marketplace. The DCA proposes to replicate the FSA requirements in respect of general insurance intermediaries, that is cover for individual claims up to €1 million with an aggregate limit of €1.5million, or 10% of annual income if higher. However, the amounts should be expressed in an approximate sterling equivalent. It may be argued that a higher figure is appropriate, to cover the maximum possible claim, and also because a significantly higher limit would lead to only a modest increase in premiums. However, those wishing to have a higher limit need to justify this in the context of the requirements for insurance intermediaries.

Question 4: What should the minimum levels of indemnity and excess be?

Timing

23. Businesses need time to arrange PI insurance, which in some cases may mean changes in policies and practices. A reasonable time should therefore be allowed between making the rules and businesses being required to have cover, particularly as there is no evidence that the absence of PI cover imposes a substantial risk at present. Authorised businesses will be required to submit a self-certification compliance statement when they apply to have their authorisation renewed for the year beginning 1 March 2008. It would seem sensible to tie in the requirements for PI cover with this statement: that is businesses that are required to have PI cover would be required to state that they have it in their self-certification statement.

Question 5: Should the requirement be introduced from 1 January 2008 or at an earlier date?

Proposed requirements

24. The following proposed requirements are put forward for consultation –

- (a) Authorised businesses that have contracts with client, whether or not they represent clients, should be required to have PI insurance.
- (b) Cover should provide for individual claims up to £650,000 with an aggregate limit of £1 million or 10% of annual income if higher.
- (c) The excess should be not more than the higher of £5,000 or 3.0% of annual income.

(d) The requirements should apply from 1 January 2008.

25. A draft of the proposed Rules is attached.

Draft

Claims Management Regulation Professional Indemnity Insurance Rules 2007

Made by the Regulator pursuant to Section 9 of and Paragraph 11 of the Schedule to the Compensation Act 2006 and Regulation 21 of the Compensation (Claims Management Services) Regulations 2006.

Application

1. These rules apply to a business that is authorised under the Compensation Act 2006 and which has contracts with clients.
2. These rules come into effect on 1 January 2008.

Requirement to hold professional indemnity insurance

3. A business shall take out and maintain professional indemnity insurance from –
 - (i) an insurance undertaking authorised to transact professional indemnity insurance in the EEA; or
 - (ii) a person of equivalent status in:
 - (a) a Zone A country; or
 - (b) the Channel Islands, Gibraltar, Bermuda or the Isle of Man.
4. The contract of professional indemnity insurance must incorporate terms which make provision for –
 - (i) cover in respect of claims for which a business may be liable as a result of the conduct of itself, its employees and its exempt introducers (acting in that capacity);
 - (ii) a minimum level of indemnity for a single claim of £650,000, and in aggregate, £1 million or, if, higher, 10% of annual turnover;

- (iii) an excess which is not more than the higher of £5,000 or 3% of annual income;
 - (iv) appropriate cover in respect of legal defence costs; and
 - (v) continuous cover in respect of claims arising from work carried out from the date on which these Rules come into effect or the date of authorisation if later.
5. Where an insurance intermediary, as an independent financial adviser, holds professional indemnity insurance that meets the requirements of the Financial Services Authority, and where regulated claims management activities are covered by that insurance, then it shall be deemed to satisfy the requirements of these rules.

Requirement to provide information

6. A business shall on request by the Regulator confirm that it holds professional indemnity insurance in accordance with these Rules and/or provide evidence that it does so.

Definitions

7. For the purposes of Rule 4 turnover shall be defined as in the Claims Management Regulation Fees Rules 2006.
8. For the purposes of Rule 3 a Zone A country is –
- (a) any EEA State;
 - (b) all other countries which are full members of the OECD; and
 - (c) those countries which have concluded special lending arrangements with the International Monetary Fund (IMF) associated with the Fund's general arrangements to borrow (GAB), save that any country falling with (a), (b) or (c) which reschedules its external sovereign debt is precluded from Zone A for a period of five years.

Questionnaire

We would welcome responses to the following questions set out in this consultation paper.

1. **Is it accepted that those businesses that are only introducers should not be required to have PI insurance?**
2. **Should businesses that represent clients have PI insurance?**
3. **Should businesses that have contracts with clients but do not represent them have PI insurance?**
4. **What should the minimum levels of indemnity and excess be?**
5. **Should the requirement be introduced from 1 January 2008 or at an earlier date?**

It would be helpful if claims management businesses would, separately from any response, supply details of their current PI insurance or details of any difficulty that they have experienced in obtaining cover.

Thank you for participating in this consultation exercise

About you

Please use this section to tell us about yourself

FULL NAME	
Job title or capacity in which you are responding to this consultation exercise (eg. member of the public etc.)	
Date	
Company name/organisation (if applicable):	
Address	
Postcode	
IF YOU WOULD LIKE US TO ACKNOWLEDGE RECEIPT OF YOUR RESPONSE, PLEASE TICK THIS BOX	<input type="checkbox"/> (please tick box)
ADDRESS TO WHICH THE ACKNOWLEDGEMENT SHOULD BE SENT, IF DIFFERENT FROM ABOVE	

If you are a representative of a group, please tell us the name of the group and give a summary of the people or organisations that you represent.

How to respond

Please send your response by 25 May 2007 to:

Niva Thiruchelvam
Department for Constitutional Affairs
Claims Management & Private Funding Branch
3.10
Selborne House
54-60 Victoria Street
London
SW1E 6QW

Tel: 020 7210 1325

Fax: 020 7201 0613

Email: claimsmanagementregulation@dca.gsi.gov.uk

Extra copies

Further paper copies of this consultation can be obtained from this address and it is also available on-line at <http://www.dca.gov.uk/index.htm>

Publication of response

A paper summarising the responses to this consultation will be published in June 2007. The response paper will be available on-line at <http://www.dca.gov.uk/index.htm>

Representative groups

Representative groups are asked to give a summary of the people and organisations they represent when they respond.

Confidentiality

Information provided in response to this consultation, including personal information, may be published or disclosed in accordance with the access to

information regimes (these are primarily the Freedom of Information Act 2000 (FOIA), the Data Protection Act 1998 (DPA) and the Environmental Information Regulations 2004).

If you want the information that you provide to be treated as confidential, please be aware that, under the FOIA, there is a statutory Code of Practice with which public authorities must comply and which deals, amongst other things, with obligations of confidence. In view of this it would be helpful if you could explain to us why you regard the information you have provided as confidential. If we receive a request for disclosure of the information we will take full account of your explanation, but we cannot give an assurance that confidentiality can be maintained in all circumstances. An automatic confidentiality disclaimer generated by your IT system will not, of itself, be regarded as binding on the Department.

The Department will process your personal data in accordance with the DPA and in the majority of circumstances, this will mean that your personal data will not be disclosed to third parties.

The Consultation Criteria

The six consultation criteria are as follows:

1. Consult widely throughout the process, allowing a minimum of 12 weeks for written consultation at least once during the development of the policy.
2. Be clear about what your proposals are, who may be affected, what questions are being asked and the time scale for responses.
3. Ensure that your consultation is clear, concise and widely accessible.
4. Give feedback regarding the responses received and how the consultation process influenced the policy.
5. Monitor your department's effectiveness at consultation, including through the use of a designated consultation co-ordinator.
6. Ensure your consultation follows better regulation best practice, including carrying out a Regulatory Impact Assessment if appropriate.

These criteria must be reproduced within all consultation documents.

Consultation Co-ordinator contact details

If you have any complaints or comments about the consultation **process** rather than about the topic covered by this paper, you should contact the Department for Constitutional Affairs Consultation Co-ordinator, Laurence Fiddler, on 020 7210 2622, or email him at consultation@dca.gsi.gov.uk

Alternatively, you may wish to write to the address below:

Laurence Fiddler
Consultation Co-ordinator
Department for Constitutional Affairs
5th Floor Selborne House
54-60 Victoria Street
London
SW1E 6QW

If your complaints or comments refer to the topic covered by this paper rather than the consultation process, please direct them to the contact given under **the How to respond** section of this paper at page 25.

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