



Recommendations for change following PII Consultation

STATUS

1. This report and the appendices are confidential as it relates to developing policy considerations.

EXECUTIVE SUMMARY

2. The public consultation relating to the proposed changes to the PII arrangements closed on 14 December 2023.
3. This paper summarises the responses received to the consultation and reports the PII Committee's recommendations for changes to the PII Regulations and ICAEW's current insurance arrangements prior to the next renewal of ICAEW's arrangements with qualifying insurers which begins in May 2024.
4. The PII Committee is recommending that only some of the original proposed changes be made after considering strong, but not unexpected, opposition to some of the more aspirational proposals both from firms and insurers. The PII Committee has taken into account the lack of available data to demonstrate that the current arrangements are having a negative impact on consumers.

RECOMMENDATIONS

5. The IRB is asked to:
 - a) approve the PII Committee's final recommendations for changes to the PII Regulations so that an amended version of the regulations can be prepared and presented at the IRB's March meeting for final approval.
 - b) confirm the classification of this paper as 'confidential'.

SUMMARY OF CONSULTATION RESPONSES

6. The consultation relating to changes to the PII arrangements ran between 18 October and 14 December 2023. A summary of the proposals put forward in the consultation is set out in **Appendix A**.
7. A webinar and Q&A session took place that sought to provide further information about the proposals and also responded to preliminary feedback received to the consultation, for example, the treatment of micro and large firms. ICAEW staff also attended separate meetings at the request of several insurers and brokers including Axa, Hiscox and Howden.

8. There were 134 respondents to the survey and separate submissions were received [REDACTED]. Unfortunately, the Legal Services Consumer Panel was unable to submit a response due to the large number of consultation responses it was working on in December.
9. The majority of responses were received from ICAEW firms, and over 80% were from firms with income below £800,000. A handful of Scottish and Irish firms also responded. In addition, eleven insurers and four brokers responded to the survey. Lead insurers also shared their views on the proposed changes during the meeting of the Joint Advisory Panel in November 2023.

Overview of responses

10. We have set out firstly a summary of those proposals which received a generally positive response from respondents to the survey:
 - a) Over half of respondents felt that the current mandatory limits of indemnity should be increased
 - b) Over 75% of respondents agreed that the insurance and excess requirements should be linked to fee income rather than number of principals
 - c) Respondents considered that £2,500 or 3% of fee income is the correct calculation for the maximum permitted excess (around 46% were in agreement and 23% were unsure)
 - d) Those respondents who chose to respond to questions relating to large firms were generally supportive of using a £50m threshold (instead of 50 principals)
 - e) It was clear from the responses that the concept of captive insurance is not well understood even by insurers/brokers and it is not considered to be a relevant issue in the accountants' market
 - f) The factors used to assess compound firms are appropriate (the response rate to this question was low (only 23) but almost all agreed with the factors suggested)
 - g) In relation to the requirements for run-off cover there was general support for removing the term "best endeavours" and replacing with "reasonable steps" for members ceasing practice (65% of respondents agreed).
11. However, there were also strong opposition to some proposals and the response to other changes were polarised including the following:
 - a) 50% of respondents thought that an insurer should not be required to meet the excess if a firm fails to pay and 78% thought this change would have a negative impact on pricing, capacity or insurer appetite
 - b) 52% of respondents did not agree that making run-off cover automatic and non-cancellable for non-payment of premium should be introduced even if the premium increased
 - c) Although there was general support for increasing the limits of indemnity, there were a number of comments received from "micro firms" (with income of less than £100k) concerning the impact on the price of their insurance if the proposals were taken forward. Some of these firms may be impacted by the proposal to increase the minimum limit from £100k to £250k

- d) 53% of respondents considered the changes would have a detrimental impact on a firm's ability to obtain insurance which complies with the PII regulations
- e) There was a mixed response to the consultation as to whether the right balance between consumer protection and availability of insurance had been reached (25% strongly disagreed, 25% disagreed and 29% agreed)

12. The PII Committee has paid particularly close attention to the reaction of insurers as one of the objectives of the exercise was to maintain the current pool of qualifying insurers and also because it was thought that insurers would be able to provide a steer as to the likely impact of the proposals on premiums. The following are a representative snapshot of insurers' responses:

13. [REDACTED] noted in relation to the proposal of making run-off cover non-cancellable for non-payment of premium:

If ICAEW applied similar extensions of cover under their PI arrangements, it can be assumed that an appetite restriction would follow and an increase in premiums for all, not just in some cases.

14. [REDACTED] one of the largest providers of insurance to ICAEW firms, when asked if the changes will have a detrimental impact on a firm's ability to obtain insurance said:

Yes as it is likely this will result in capacity being withdrawn and pricing increasing for Insurance cover.

15. [REDACTED] commented, in response to whether ICAEW had struck the right balance between consumer protection and availability of insurance with the following:

Strongly disagree as this could lead to customer harm for some of the firms as their Insurance premiums will need to increase due to the increased costs Insurers will incur, which are then likely to be passed onto the end client. There could be less choice of Insurers as they withdraw capacity. As an alternative we suggest you continue on the existing basis or set up a levy as noted in the answer to question 20.

16. The International Underwriting Association is a body that represents the interests of insurance companies across lines of business including some of ICAEW's participating insurers. The IUA submitted a robust response. The IUA was supportive of proposals to increase limits and to link to fee income rather than principals and adding flexibility to large firms. However, the IUA also expressed a number of concerns including:

IUA are concerned about the timing of these changes as we are not aware of any market failure, with cover broadly available to most entities that are not financially distressed. These changes, if adopted, are likely to have significant implications for the availability of and affordability of insurance for many insureds and especially for smaller entities.

PII COMMITTEE'S RECOMMENDATIONS

17. On 18 December 2023 the PII Committee met to consider the responses to the consultation and to decide which proposals, if any, should be recommended to the IRB to take forward, which proposals should be modified or if any should be withdrawn.
18. The PII Committee has been concerned throughout this process about the potential impact of unintended consequences of the changes, in circumstances where the feedback from the Call for Evidence and the consultation responses was that the accountancy market is working well, there is good availability of insurance and it is generally much cheaper compared to other professions. The PII Committee does not believe that it is in anyone's interests to disrupt the market and make it more difficult for ICAEW firms to obtain insurance as this, in turn, would have a negative impact on consumer protection.
19. The PII Committee noted the strong opposition received from insurers relating to some of the changes, particularly those comments that indicated that insurers would assess whether they would be willing to participate in the arrangements and indications that there would be a significant impact on the price of insurance for ICAEW firms, with the potential for this to impact smaller firms disproportionately.
20. Throughout the review, the PII Committee has been keen to avoid any unintended consequences which may negatively impact the current arrangements. The Committee want to avoid making changes that reduce the number of participating insurers as this could negatively impact competition; or introduce measures that adversely affect the availability of insurance, the protection offered by the minimum wording, the price of premium and the firm's ability to pay for its own insurance. The PII Committee also wanted to maintain the viability of the Assigned Risk Pool (ARP), which offers insurance to firms who are unable to source open market cover, and a huge influx of firms into the ARP could lead to the ARP being wound up.
21. The key objective of the review was to ensure the PII requirements offered sufficient protection to the public but at a sustainable cost to the profession. It is important that ICAEW firms can purchase insurance from quality insurers on terms that offer good protection to the firm's clients. Therefore, the PII Committee concluded that not all of the proposals should be taken forward at this time and that further evidence and data should be sought in order to re-assess the position at a later date. The potential to disrupt the market was clear from the responses received to the consultation.
22. The PII Committee is satisfied that the changes which are still recommended will likely benefit consumers. In particular, the requirement that the minimum limits of indemnity are increased should ensure that there is a larger amount available for payment of higher claims and should reduce the likelihood of underinsurance.
23. As a result of some of the responses received to the consultation, the PII Committee and PSD staff have also identified potential areas where more educational content could benefit members and we plan to collaborate with the PII Committee to produce website content and articles/webinars relating to these areas. For example, the distinction between fee income and potential for large claims, the basis of insurance, claims notification, as well as the importance of planning for cessation of practice from an insurance perspective.
24. A more detailed summary of the recommendations and rationale of the PII Committee is available at **Appendix B**.

Recommended Changes

25. In summary, the PII Committee recommend that the following proposals should form part of the new arrangements:

- a) The **minimum limit of indemnity should be increased**, so that generally, firms will be required have a £2million any one claim and in total limit of indemnity. However, if a firm's gross fee income is less than £800,000, the minimum limit of indemnity for any one claim and in total should be equal to two and a half times its gross fee income, with a minimum of £250,000.
- b) If a firm's gross fee income is **over £50m** they will not be required to put in place qualifying insurance but will need to have in place reasonably appropriate arrangements for their exposure to risk, which will be periodically qualitatively assessed. This proposal replaces the current "50 principal rule".
- c) The self-insured amount should be structured to **permit an excess** rather than a deductible (so that the full extent of the limit of indemnity would be available above any excess).
- d) For firms required to put in place qualifying insurance, the **maximum permitted aggregate** excess will be the higher of £2,500 or 3% of a firm's fee income.
- e) A new **definition of a compound firm** should be introduced with additional guidance regarding calculating the group's fee income and required level of insurance.
- f) The reference to "best endeavours" should be replaced with "**all reasonable steps**" when referring to members who are ceasing to practice.
- g) The **guidance relating to dispensation** applications should be updated.

Proposals to be withdrawn

26. The PII Committee recommends that the following proposals should be withdrawn at this stage:

- a) The proposal to extend run-off cover from two to six years, which would be non-cancellable for non-payment of premium should be withdrawn. As a result, the current arrangements relating to **run-off cover** (except the removal of "best endeavours") should be maintained. There was strong opposition to this proposal from firms and insurers and the PII Committee felt that there was insufficient data to justify introducing this given the potential impact on the operation of the market.
- b) The proposal that insurers should meet any **unpaid excess** for claims a firm cannot settle due to its insolvency, should also be withdrawn. There is little evidence that this is currently a significant problem and the amount a firm can take as an excess is already capped at an aggregate amount. Also, the change relating to the excess calculation will also mean that the amount of excess will reduce for smaller firms under the new proposals and this should lessen the potential impact of any unpaid excess.
- c) The proposal relating to **flexibility for defence costs and the excess** should not be taken forward. The PII Committee considered that the current arrangements work well and it is a useful protection for firms and did not want to unintentionally create an unhealthy dynamic for the claims process.

27. In making these recommendations to withdraw original proposals, the PII Committee recommends to the IRB that the position in relation to those areas remains under review and that consideration should be given as to what data that could be collected e.g. via the ICAEW annual return and insurer sign-up process so that any issues can be identified and assessed again in the future.

Additional Considerations

28. The PII Committee also agreed that further discussion relating to the changes would be beneficial once an initial draft of the proposed amendments is available and any feedback from the IRB has been received. For example, the PII Committee has indicated it would like to further reflect on the general drafting of the proposed amendments as well as the impact on micro firms, the specific guidance relating to compound firms and dispensations as well as the qualitative assessment of large firms.

29. Fees for dispensation applications-

30. While there was a mixed response to the question of whether a fee should be charged for making a dispensation application, PSD propose that this requirement is implemented to bring the PII dispensation process in line with other applications which generate work for PSD (and to comply with the user pays principle). The PII Committee did not object to a fee being charged but would like the fee to be set at an 'affordable' level given that firms considering such applications may well be struggling financially and the Committee does not believe that there should be a great disincentive to using the dispensation process. PSD would propose that the IRB agree this in principle and then consider the proposal which the PSD Finance Director makes in his May budget paper.

NEXT STEPS

31. PSD has instructed [REDACTED] to assist with the re-drafting of the PII arrangements. PSD specialist staff will produce a first draft and submit it for specialist review before a set of final regulations are presented to the IRB for its approval at the March 2024 meeting.

32. CAI and ICAS, who share the PII arrangements with ICAEW, have been kept up to date and will also update their respective regulatory boards to obtain the necessary approvals in March 2024.

PROJECT TIMETABLE

The outline timetable for the project is as follows:

Time	Action
April- June 2023	ICAEW conducts Call for Evidence
16 October – 14 December 2023	Public consultation on changes
18 December 2023	PII Committee considered consultation responses and agreed updated recommendations
December 2023 / January 2024	Review responses to consultation and reflect on feedback received. Liaise with ICAS and CAI as necessary. Begin work on re-drafting of regulations.

January 2024	Instruct external legal advisors to provide input on redraft of the PII regulations and guidance
25 January 2024	Report to IRB with update following consultation
February 2024	Finalise amendments to PII regulations
Mid-February 2024	Publish summary of consultation responses and updated proposals
20 February 2024	Provide update to ICAEW Board
23 February 2024	Scottish Regulatory Board consider proposals
6 March 2024	Irish Regulatory Board consider proposals
28 March 2024	IRB sign-off final proposals (delegate non-substantive edits to PII Committee Chair)
Early April 2024	PII Committee review any feedback from Institutes' regulatory boards and make any required final amendments
April-May 2024	Apply to relevant oversight regulators for approval of amended regulations
June 2024	Insurance arrangements renewal packs issued to insurers
1 September 2024	Revised PII Regulations come into force

APPENDICES

	Appendix Name	For consideration or for reference	No of pages
Appendix A	Overview of Proposed Changes contained in the consultation	Consideration	1
Appendix B	Recommendations Summary	Consideration	5

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