



# ***A review of ICAEW's Professional Indemnity Insurance Requirements***

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## PURPOSE OF THIS CONSULTATION

The [ICAEW Regulatory Board](#) (IRB) of ICAEW is consulting on proposed changes to ICAEW's Professional Indemnity Insurance (PII) arrangements for transparency and to ensure that they are consistent with its duty to act in the public interest. Consulting also helps protect against any unforeseen or unintended consequences that may be brought about by the changes.

We encourage you to comment on the proposed changes including our analysis of the potential challenges and impact. We acknowledge that this is a technical area and that any changes require a careful balance between acting in the public interest while also maintaining a functioning PII market with enough capacity that offers affordable premiums.

This consultation is likely to be of interest to ICAEW members, ICAEW member firms/regulated firms and their clients, non-members who are registered with ICAEW for a regulated activity, ICAEW's participating insurers, insurance brokers as well as consumers and consumer groups and other professional services regulators.

The consultation will run between **16 October and 8 December 2023**.

## BACKGROUND

ICAEW's role as an improvement regulator is to strengthen trust in ICAEW Chartered Accountants and firms. We do this by enabling, evaluating and enforcing the highest standards in the profession.

We act in the public interest, and it is part of our role to strive to ensure ICAEW Chartered Accountants and ICAEW supervised/regulated firms act with integrity and undertake work correctly and to the highest standards. Most people receive a good service, however, when things do go wrong the impact can be profound; both financially and personally.

PII is mandatory for ICAEW members in public practice and individuals and firms that undertake activity which is regulated by ICAEW under statute i.e. audit, insolvency, exempt investment business and probate (for simplicity we will refer to this group as 'ICAEW firms' in the remainder of this document). Insurance plays an important role in protecting the public interest and maintaining public confidence in instructing ICAEW firms. We set and monitor compliance with the minimum level of PII cover for ICAEW firms.

Firms which are within scope of ICAEW's regulations currently have a duty to take reasonable steps to meet claims arising from public practice. As part of this duty, firms/groups of firms with fewer than 50 principals must put in place '**qualifying insurance**'. This is insurance which:

- is provided by a '[participating insurer](#)'<sup>1</sup>;
- complies with ICAEW's [minimum approved policy wording](#); and
- provides 6 years' retroactive cover (i.e. cover for claims arising in relation to activities carried on by the firm during the last 6 years save for circumstances and claims known about prior to the inception of the policy).

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<sup>1</sup> A list of insurers are [available here](#).

## **Why are we consulting?**

Several issues have necessitated the need for review of ICAEW's PII arrangements including:

- The changing nature of the structure of firms and their insurance arrangements
- Financial capacity of members and entities to retain (self-insure) risk
- Pressure to manage the cost of insurance
- An increase in firms unable to source qualifying insurance

ICAEW's PII Committee<sup>2</sup>, is responsible for keeping under review ICAEW's policy on compulsory PII and considering revisions to the PII regulations. Although amendments have taken place periodically, a wide-ranging review of all the insurance arrangements has not taken place for some time and that the current limits of insurance have not changed since 2008.

In 2022, the IRB requested the PII Committee, together with senior managers from ICAEW's Professional Standards Department (PSD) to conduct a review of the PII requirements with the aim of ensuring they remain fit for purpose and provide adequate protection to the public and to firms, while being mindful of the cost and availability of insurance to the profession.

## **CALL FOR EVIDENCE & STAKEHOLDER ENGAGEMENT**

A Call for Evidence was launched in April 2023 to gain a better understanding of issues faced in the insurance market. We conducted an online PII survey that sought views from a broad range of members and also a series of targeted meetings so that we could have detailed discussions with a range of stakeholders.

The key topics of discussion centred around the following areas:

- a) How much insurance should firms have, and how should the amount be calculated/vary depending on firm size etc?**
- b) How to address the use of very large commercial insurance programmes (including captives).**
- c) What run-off cover should be required for firms ceasing to trade?**
- d) Arrangements and qualifying conditions for dispensation.**

We were pleased to hear that generally respondents felt that our current arrangements worked well and ICAEW firms were able to purchase compliant insurance at a level they desired and that was appropriate for their business. The biggest PII challenge for respondents to our survey was price.

A summary of the discussion questions and key themes gained from the Call for Evidence is available and we refer to the results generally throughout this consultation. We have used this insight, in collaboration with the PII Committee and IRB, to help formulate the proposed changes to arrangements.

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<sup>2</sup> Further information about the function and operation of the PII Committee [can be found here](#)

## SUMMARY OF PROPOSED CHANGES

Following its review of the responses to the Call for Evidence, the PII Committee is recommending the following changes to ICAEW's PII arrangements:

- 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**. Defence costs will continue to be in addition to the limit of indemnity.
- 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.
- If a firm's gross **fee income is over £50m** it will be classified as a "large firm". Large firms will not be required to put in place qualifying insurance but they will continue to have the obligation to have in place reasonably appropriate arrangements for their exposure to risk which is qualitatively assessed.
- 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).
- Generally, defence costs should not be applicable to the excess (except in the case of FCA authorised work, as is currently the case). However, if a firm's gross fee income is over **£800,000** then the excess may be applied to defence costs.
- For firms required to put in place qualifying insurance, the maximum permitted aggregate excess will **be the higher of £2,500 or 3% of the firm's fee income**.<sup>3</sup>
- If a firm fails to pay a claimant any amount which is within the excess due to its insolvency, the insurer will become liable to remedy the default on the insured firm's behalf.
- Further guidance will be provided regarding 'compound firms' to make it clear in what circumstances firms can insure multiple entities within a group under a single policy of insurance
- Qualifying insurance should provide automatic run-off cover for 6 years, which is non-cancellable by insurers for non-payment of premium.
  - Automatic run-off cover would be for a single aggregate limit of indemnity across the entire 6-year run-off period. This limit would be calculated in the same way as the annual aggregate minimum limit required by the firm's qualifying insurance directly preceding the cessation of the practice.
  - Participating insurers should be required to outline at inception of a policy how the premium for run-off cover will be calculated.
- The guidance regarding applications for dispensation should be updated to ensure the process is clearer and more transparent. A fee for processing dispensation applications will also be introduced.

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<sup>3</sup> Currently firms are permitted to have an aggregate deductible of £30k x number of principals.

## DETAIL OF PROPOSED CHANGES

### How much insurance should firms have, and how should the amount be calculated/vary depending on firm size etc?

#### Current Requirements

Currently, [PII Regulation 3.1\(a\)](#) requires firms to take reasonable steps to meet claims arising from public practice. PII Regulations 3.2 and 3.3 specify that the minimum limits of cover are 2.5 x a firm's gross fee income for the previous accounting period, subject to a minimum of £100k and a maximum requirement of £1.5m per claim and aggregate. Special limits of indemnity apply in the case of accredited probate firms and DPB-licensed firms carrying on insurance distribution activities under PII Regulations 3.4 and 3.5. The PII regulations also set out the requirement to hold "qualifying insurance".

As part of the minimum limit of indemnity, firms are permitted to hold a deductible of up to £30k per principal in the aggregate. If more than one firm is insured under the policy, the total number of principals across all firms should be calculated, but only including natural persons and an individual should only be counted once. Guidance to PII Regulation 3.7 confirms that where firms have 50 or more principals, the requirement to put in place compliant 'qualifying insurance' is waived (colloquially known as the "50 principal rule").

Defence costs are payable in addition to the limit of indemnity (clause C1.2 of the minimum wording) and should not apply to the excess except in the case of FCA authorised work (clause C3.2 of the minimum wording).

#### Limits of Indemnity

The PII Committee recommends that the minimum limits specified in the PII regulations, which have been set at the same level since 2008, should be increased. The feedback received during the Call for Evidence is that the minimum limits may now be insufficient given the rising costs of claims and inflation. The specific changes proposed are:

- 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**.
- If a firm's gross fee income is less than £800,000, the minimum limit of indemnity for any one claim and in total is equal to **two and a half times its gross fee income**, with a **minimum of £250,000**.

The majority of respondents to our survey thought that the current limits were about right or too high, therefore, they may be disappointed with our proposed change. However, based on our analysis of firms' annual returns, we understand that most ICAEW firms purchase cover on "any one claim" basis, usually over and above the minimum limit specified in the regulations, so we do not anticipate that this change will cause any increase in premiums to the majority of ICAEW firms. For those firms that do purchase the minimum, there may be modest amendment in pricing at the lower end (firms that would be required to purchase £250,000 in the aggregate rather than £100,000). However, after our discussions with market advisers, we understand that given the low minimum limits of these policies, a significant part of pricing will relate to the fixed costs of issuing the policy and so any increase in premium is likely to be minimal. We consider that this is offset by the increase in financial

protection for the consumer, as well as the firm itself, due to the availability of a higher limit of indemnity for any claims received which should reduce the likelihood of under-insurance.

The special limits of indemnity for accredited probate firms and DPB-licensed firms carrying on insurance distribution activities under PII Regulations 3.4 and 3 will continue to apply.

The use of a firm's gross fee income to calculate the minimum limit is already used in the PII regulations and we are proposing that this is retained. The feedback received from the Call for Evidence is that this is easy to understand and that the use of a "sliding scale" relating to a firm's size/income is useful, it frees up capacity in the market and assists in reducing premium cost by allowing some flexibility.

### **Permitted Excess**

The PII Committee recommends that the maximum excess should also be linked to a firm's fee income rather than the current system which permits a deductible of £30,000 multiplied by the number of principals. The proposed change is that for those firms that are required to put in place qualifying insurance, the maximum permitted aggregate excess will **be the higher of £2,500 or 3% of the firm's fee income.**<sup>4</sup>

The self-insured amount should also be structured to permit an excess rather than a deductible.<sup>5</sup> Based on our discussion with stakeholders, we understand that most ICAEW firms' insurance policies are already written on this basis so we consider this change will ensure the regulations are clearer on this point and ensure that the full limit of indemnity will be available to meet claims. This change will standardise the amount of insurance available to meet claims over and above the amount paid by a firm and means there is a minimum level of financial protection for consumers and ensures there is redress available which is appropriately balanced. Firms will continue to be permitted to have an excess on an "each and every claim basis" at a level agreed with their insurer, but the maximum amount will be capped based on this calculation (as already occurs with clause C3.3 of the minimum wording).

- 1. To what extent do you think the proposed changes to the minimum limits provide an appropriate minimum level of cover for an ICAEW firm? Please explain your answer.**
- 2. Do you agree with our proposed approach that the required insurance arrangements (in terms of the required limit and permitted excess) should all be linked to a firm's gross fee income? If not, what measure would you propose?**
- 3. We are proposing to increase the minimum level of cover from £100,000 to £250,000. What factors, other than the impact on price, should be taken into account when we assess this policy change?**
- 4. Do you agree that the higher of £2,500 or 3% of a firm's fee income is the correct calculation for the maximum aggregate excess permitted for firms? If not, what do you consider is an appropriate measure / metric? Please provide your reasons.**

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<sup>4</sup> Under the new proposals firms with fee income over £83,333 will be permitted to have a maximum excess of 3% of its fees.

<sup>5</sup> Currently, a firm could have a £1.5m aggregate policy limit and £1m deductible/excess; if a claim for £2m is received, the firm would pay £1m and the insurer would pay £500k. The remaining £500k could be met by excess insurance if in place or would not be insured. The new arrangements would mean that in these circumstances the £1m would be an excess and not be deducted from the available limit, so that the insured firm would pay £1m, then the insurer would meet the remaining £1m (but only up to the limit of indemnity if a larger claim was received).

During the Call for Evidence, we received feedback that, as defence costs are not applicable to the excess, this can lead to “pound swapping” between insurer and larger insured firms, who are likely to receive a higher number of claims, so that insurers simply pass on the cost of paying for defence costs to the insured in the form of the amount of premium charged. Both firms and insurers we spoke to said that they would welcome some greater flexibility regarding the operation of defence costs and the excess and that this may lead to premium saving. In addition, in relation to smaller firms, who may not have the resources or experience to manage claims internally, the feedback we received was that insurers taking control of a claim at an earlier stage is useful and should be retained.

Therefore, the PII Committee is proposing that firms with fee income over £800,000 should have a greater degree of flexibility regarding the excess and should be permitted (if they chose to do so) to have defence costs apply to the excess. This threshold was chosen as it also corresponds to those firms who are required to have in place the maximum limit of indemnity (as £800,000 x2.5= £2m).

The PII Committee has also recommended that the changes should shift the insolvency risk of the insured firm towards the insurer rather than the claimant. If implemented, this change would mean that any unpaid excess (arising due to the inability of the insolvent firm to pay it) would be met by the insurer, with a right of recovery against the firm.

The PII Committee considers this would be a valuable consumer protection tool to ensure that a claimant would receive financial compensation even in the event of a firm’s inability to pay the excess but is also wary of the impact on pricing, capacity and appetite and so would particularly like to hear from insurers regarding this proposed change. Should this change be operative only in the event of a firm’s insolvency or should this be of wider application, for example, in any circumstance, where the firm does not pay the excess within a specified time period (for example 3 months)?

We are also aware that the firm’s ability to negotiate a very high excess is already restricted given the presence of a maximum aggregate permitted excess, which should already help to reduce the likelihood of any non-payment of excess occurring.

- 5. What are your views on the proposal that firms with fee income over £800,000 may apply defence costs to the excess? Should this choice be available for all firms, or just those that meet certain size-related criteria?**
- 6. To what extent do you agree that giving firms more flexible options regarding defence costs and the excess will potentially lower insurance costs?**
- 7. What are your views on the proposal that in the event of a firm’s insolvency any unpaid excess should be met by the insurer?**
- 8. Do you think that that an insurer should also be required to meet the excess if the firm fails to pay within 3 months?**
- 9. What action, if any should be taken against a firm that fails to pay the excess within this period (e.g. automatic cancellation of cover, disciplinary action, accelerated monitoring visit etc.)**
- 10. Do you consider that shifting the insolvency risk could have a negative impact on pricing, capacity or insurer appetite? Please provide details to support your response.**

## Compound Arrangements

PII Regulation 3.8 and 5.3(c) deal with “compound firms” and acknowledges the use of insurance for group arrangements. Previously, the PII Committee issued guidance that there should be some element of common ownership and control to permit the use of a compound firm.

*3.8. If the Committee is satisfied that a group (however composed) of firms has shown that together they comply with these regulations, it is at the Committee's discretion to allow that group to be treated as a single entity (compound firm) for the purposes of these regulations.*

*The Committee can treat a 'group' of separate firms as a compound firm. Such a firm will usually comprise a number of associated firms which appoint one of their number to arrange insurance under one policy*

*5.3(c) allow a firm subject to these regulations to combine with others to comply with these regulations;*

The PII Committee understands the benefits of insuring a group under a single policy of insurance and recommends that the discretion to permit a compound firm is retained in the regulations. However, it is concerned that this could lead to under-insurance if firms have not properly considered the appropriate level of insurance required for the group's size, activities and level of risk. For example, it may not be appropriate for a group of firms to share only one minimum aggregate limit of indemnity across the group or to aggregate an excess.

The PII Committee recommends that the regulations are updated to contain additional guidance about what constitutes a compound firm, so it is clear how firms within a group or other arrangement can comply with the PII Regulations where they are insuring more than one entity under a single policy of insurance.

The PII Committee considered the factors used to determine whether a structure constitutes a 'network firm' in [ICAEW's Code of Ethics](#), and whether these factors capture the characteristics of a compound firm for PII purposes. The PII Committee proposes that a similar approach should apply to a compound firm, who would be expected to demonstrate that it is part of a “larger structure which is aimed at co-operation” and that it meets at least a number (for example, three or more) of the criteria set out below:

- a) It is clearly aimed at profit or cost sharing among the entities within the structure
- b) The entities within the structure shares common ownership, control or management
- c) The entities within the structure share common quality control policies and procedures
- d) The entities within the structure share a common business strategy
- e) The entities within the structure share the use of a common brand-name
- f) The entities within the structure share a significant part of professional resources

Compound firms would also be permitted to combine each individual firms' fees to calculate their total fee income, which would determine the required limit of indemnity and permitted excess for the compound firm. However, in many cases the minimum requirements may not be appropriate for a group of firms. Therefore, the PII Committee will also enhance the guidance to the regulations to make it clearer that groups taking advantage of a single policy must ensure there is adequate cover for each entity in the group, and to consider the appropriateness of aggregating the excess.

We are keen to hear from firms who structure their insurance using a compound arrangement and whether this definition would work for your situation.



- 11. Do you think the factors used to assess whether a group can be treated as a compound firm are appropriate? If no, please provide feedback including any alternative factors which should be used.**
- 12. What are your views on how many of the proposed criteria a firm would need to demonstrate in order to be a compound firm?**
- 13. Do you have any other comments regarding compound firms and permitting multiple entities to be insured under a single policy? If you are part of a group we would also like to hear whether you think this guidance is easy to apply to your situation.**

## **How to address the use of very large commercial insurance programmes**

### **Large Firm Threshold**

The PII Committee recommends that the '50 principal rule' is replaced with a large firm threshold which means that the exemption for large firms from the requirement to hold qualifying insurance would apply to firms with gross fee income of over £50m, rather than the current arrangement of those firms with over 50 principals. These larger firms would be subject to a qualitative assessment which would consider whether the firm's arrangements meet the requirement of taking "reasonable steps to meet claims arising from public practice".

Although, in our survey most respondents felt 'principal' was an easy term to understand, the feedback from interviews and our own experience is that it is outdated when considering modern corporate structures used by our firms that no longer use the traditional partnership structure. The term 'principal' can also cause difficulties when applying to cases where there may be de facto principals, or individuals who are not statutory principals but do take some control of the firm, for example, senior partners and managing directors. A change to the use of fee income should standardise the distinction of a 'large firm' and be easier to understand and more transparent.

We also asked respondents in the Call for Evidence about the use of captive insurers and the feedback received was that their use was infrequent, with little or no demand from smaller/medium sized firms and this not expected to change in favourable market conditions. The PII Committee recommend that the guidance to the PII Regulations should make clear that firms should not be able to put in place qualifying insurance with a captive insurer. Firms above the large firm threshold would continue to be permitted to put in place their own insurance arrangements which can include the use of a captive insurer.

- 14. What are your views on moving from a large-firm threshold based on a firm's number of principals to one based on a firm's gross fee income?**
- 15. Are there any factors to consider when defining the term 'gross fee income' that will be used to determine if a firm, or group of firms, exceeds the proposed £50m threshold?**
- 16. Do you agree we have set the large-firm threshold at the right level? Yes/No If not, what alternative threshold would you propose and why.**
- 17. Are there any situations where a firm should be permitted to place qualifying insurance with a captive insurer? If yes, please can you provide details.**
- 18. In your view, what should a qualitative assessment of a large firm's PII entail?**

## What run-off cover should be required for firms ceasing to trade?

### Run-Off: Current Requirements

Requirements for run-off cover are specified in PII regulations 2.7 and 2.8. A distinction is made between situations where a member ceases practice (for example they retire) and when the entire practice is being closed or is ceasing to trade. Where firms cease, the members in practice in the firm must ensure that compliant cover is in place for at least two years and, thereafter, they must use their best endeavours to maintain compliant run-off cover for a further four years (Regulation 2.8). If a member is ceasing to practise (rather than the entire firm) then the member is required to use their best endeavours to ensure they are covered by arrangements which comply with ICAEW's regulations. Cover should be in place for at least two years after they cease (Regulation 2.7).

ICAEW's minimum terms (see clause D4) require that, if a firm ceases during the policy of insurance, then insurers should provide run-off cover for a minimum of two years from the date of cessation. This cover is subject to payment of an additional premium by the firm.

### Run-Off: Proposed Changes

As part of the Call for Evidence, we considered other professional regulators' run-off requirements and found that most regulators require a mandatory run-off period of six years. Six years is the usual limitation period for professional negligence claims. However, we also understand from our discussions with insurers that the majority of claims are made in the first two years of run-off, and that is it unusual to have many claims after a six year period.<sup>6</sup> Most interviewees told us that they expected six years run-off as standard and thought that reference to "best endeavours" within the regulations is ambiguous and unhelpful. The feedback we received from brokers and insurers was that generally run-off cover is available for ICAEW firms if they take out cover with their existing insurer, but there is little appetite for insurers to take on a firm purely for run-off purposes. We also received feedback that it was difficult for firms to predict prices or plan for run-off but insurers thought that any changes to our current requirements may have pricing and appetite implications.

We see run-off cover as vital in protecting the financial interests of firms' clients and ensuring adequate run-off cover in place for enough time will ensure that the public interest is advanced.

The PII Committee is keen to bring ICAEW's requirements in line with other regulators and recommends that the regulations are amended so that six years' run-off cover is mandatory for ICAEW firms that are ceasing to trade. However, it is also concerned to ensure that such an extension is one which would be supported by participating insurers offering such cover at a reasonable cost.

### Automatic Cover

As a further protection, the PII Committee considers that participating insurers should be required to provide six years' run off cover which should also be non-cancellable for non-payment of premium. This would mean that ICAEW's minimum terms would automatically provide six years run-off cover.

The automatic cover would require a single aggregate limit of indemnity across the entire six-year run-off period. This limit would be calculated in the same way as the annual aggregate minimum limit

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<sup>6</sup> This accords with the [SRA's assessment](#) of their own historical analysis of solicitors' run off claims which indicated approximately 90% of run-off claims are made within a six year period.

required by the firm's qualifying insurance directly preceding the cessation of the practice.<sup>7</sup> Of course, firms should reflect on whether this is sufficient when considering the relevant run-off cover to purchase. However, this change should ensure that there would be some insurance in place for firms who cease suddenly or are not able to pay for run-off.

The PII Committee also recommends that insurers are required to include a formula which sets out how the premium would be calculated within the contract of insurance, for example specifying that the run-off premium will be a certain percentage of the current premium. This will ensure the process is transparent, and firms can prepare early for funding the cost of run-off cover. We welcome feedback on the structure of this formula and whether variations should be permitted if a firm receives claims for example.

We anticipate that this proposal may result in an increase to some premiums as insurers would have to account for the risk that firms would not pay for run-off cover. However, this should be tempered by the fact that the automatic cover is a single aggregate limit across a six-year period (rather than any one claim cover) and, therefore, insurers will be aware of the maximum claims payments that could be made over that period (defence costs would continue to be in addition to this limit). We also understand that most firms who cease do pay for run-off cover and, therefore, we expect this issue to be of limited impact across the population of ICAEW firms.

We are aware that the proposed changes to run-off requirements may not be welcomed by insurers<sup>8</sup> and the PII Committee is requesting feedback regarding the impact on premium pricing, capacity and insurer appetite for these changes.

### **Members Ceasing to be engaged in public practice**

The PII Committee would also like to clarify the obligations on members ceasing to be engaged in public practice. We are proposing that the requirements of regulation 2.7 are amended so that a member must take reasonable steps to ensure they are covered by appropriate arrangements which satisfy the regulations. The reference to "best endeavours" and limiting this obligation to at least two years after ceasing to be in public practice will be removed.

The PII Committee acknowledges an ICAEW member's ability to influence a firm's insurance arrangements after they have retired is limited. This change would not be watering down the importance of run-off cover or the requirement that historic work is covered by insurance; the guidance to this regulation would continue to stress its importance. Instead, this proposed change acknowledges that run-off cover for a member ceasing to engage in public practice or retire, would nearly always be met by their former-firm's ongoing insurance cover. However, an obligation would remain for the member to take reasonable steps ensure appropriate arrangements are in place at the point in time that they leave the firm.

If a sole practitioner was ceasing to practice, this situation would be covered by the obligation on a firm ceasing and would mean automatic run off cover for six years would be in place.

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<sup>7</sup> For example, if a firm with fees of £900k had a policy at the time of cessation with limit of indemnity of £3m any one claim, then under the proposed arrangements, the policy for run off across the 6-year period would require a minimum aggregate limit of £2m rather than the same limit as the existing policy.

<sup>8</sup> We are aware of the IUA's position in relation to run-off and other elements of the solicitors MTCs in their [open letter](#) to solicitor firms from 2020.

- 19. What are your views on the proposal to increase the run-off period for ICAEW firms that cease to six-years?**
- 20. We are proposing that the minimum terms offer automatic run-off cover that is non-cancellable for non-payment of premium, do you think this change should be introduced even if this increases the premium in some cases? If not, why not.**
- 21. Do you agree we have reached the right balance between adequate consumer protection and the availability/potential impact on price of run-off insurance under the proposed new arrangements? If not, please explain your reasoning and what alternative option you consider more appropriate.**
- 22. Do you think the use of formula for specifying up-front the calculation of how the run-off premium would be calculated (if run-off is required) is appropriate? If not, what issues could this create and can you explain what you think should be an alternative option.**
- 23. Are you in favour of us amending the obligation on members ceasing to be in public practice to remove reference to 'best endeavours' and instead use 'reasonable steps' to ensure they are covered by appropriate arrangements which satisfy the PII regulations? If not, please provide details of your concerns and outline any alternative solutions.**

### **Arrangements and qualifying conditions for dispensations**

In exceptional circumstances, the PII Committee has an absolute discretion in granting dispensations to firms from compliance with one or more elements of the PII Regulations (see Regulation 5.3). Guidance for the PII Committee on the exercise of this power is set out in Appendix B to the PII Regulations. Most commonly, applications are brought under PII Regulation 5.3(d), which provides the Committee with the power to *"waive or relax the requirement [on a firm] to hold qualifying insurance"*, for example, where the proposed policy includes one or more non-compliant terms. More rarely, applications have been brought by firms to hold cover with one or more non-participating insurers.

The PII Committee's view is that the proposed changes to the overall arrangements should address some of its previous concerns relating to firms applying for dispensation, for example, the operation of the 50 principal rule for firms with very high fee income but a small number of directors.

Therefore, the PII Committee is not proposing any substantial changes to the dispensation process or grounds for dispensation set out in PII regulation 5.3. However, following feedback from firms and other stakeholders as part of the Call for Evidence, we are proposing to update the guidance in Appendix B to ensure that the process is clear, specify the likely considerations of the PII Committee (albeit they would retain an absolute discretion) as well as ensuring the process for challenging a decision is clear, transparent, and accessible. We will also be updating the application form and website guidance.

The PII Committee is also proposing to charge an application processing fee for dispensations (and a renewal fee if a further dispensation is required in subsequent years). This would be a non-refundable fixed fee to cover the staff costs of processing the application and payable before the application is considered.

**24. How could the existing process to make an application for dispensation be improved or streamlined? Do you have any comments or feedback we should consider when re-drafting the guidance to Appendix B in the PII regulations?**

**25. Do you think that ICAEW should charge firms an application processing fee for making an application for dispensation?**

## **ASSESSMENT OF IMPACT**

We have summarised below what we consider to be the key benefits, costs and challenges which may result from these changes and welcome your feedback as to whether we have identified the correct issues.

### **Consumer protection and promoting the public interest**

One of the key considerations when considering the interests of consumers is that when things go wrong there is a system of redress for putting them right<sup>9</sup> and our view is that appropriate PII insurance, that responds to a claim when things do go wrong, is a cornerstone of this approach. We think that these changes will have a positive impact on consumer protection and promoting the public interest generally. We see the changes as creating positive benefits, including:

- An increase in the minimum limits of indemnity available to cover for claims which should increase the amount of financial compensation available.
- The entire minimum limit would be available to claimants rather than being partially eroded by any self-insured deductible.
- Claims payment would not be reduced if a firm did not pay their excess due to insolvency.
- Run-off cover would be automatic and non-cancellable in the event of non-payment of premium which would ensure that financial protection is in place for consumers in all circumstances and would not be dependent upon the firm's ability to pay for and source run off cover.

### **Fees, level of risk and transparency**

If these proposals are adopted a firm's fee income becomes relevant in determining the type of insurance required, the corresponding minimum limit of indemnity, the amount of permitted excess and whether defence costs can apply to the excess.

There are two key thresholds, firstly, firms that have fee income over £800,000 can have a policy where the excess can also be applied to defence costs, and secondly, firms that have over £50m in fees would not need to put in place qualifying insurance.

We consider that using fee income rather than the number of principals is easier to apply and therefore it will be clearer to firms, their insurers/brokers and their clients what minimum levels of insurance is required to comply with the PII regulations. It will also address the position of firms whose operating model produces significant revenue with a low number of principals.

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<sup>9</sup> Legal Services Consumer Panel, The consumer interest, January 2014

We acknowledge that the level of a firm's fees does not necessarily reflect the level of risk of the work that a particular firm may be performing. Importantly, there will remain a regulatory requirement for firms to take reasonable steps to meet claims arising from being public practice. There is also a requirement to carry out a risk assessment and take any appropriate action. This means that for many firms the regulatory minimum level of cover may not be appropriate.

Most ICAEW firms opt to take insurance on an "any one claim basis"<sup>10</sup> which provides more cover to the public than the regulatory requirement for aggregate limits and many firms will purchase limits above the minimum in light of their own assessment of risk. This accords with the feedback we received when speaking with stakeholders that certain work types are likely to require higher than the minimum levels of cover, but that the firm and its broker would be best placed to assess that depending on a case-by-case basis. Therefore, we are proposing that the guidance regarding risk assessment and level of cover is retained (see regulation 6.12 and 6.15).

We consider that the minimum limits combined with the requirement to meet claims arising from being in public practice strikes the right balance between ensuring a minimum level of protection for consumers whilst also permitting some degree of flexibility which acknowledges the wide-range of firms, work types and other risk factors found within the firms we regulate.

We have also considered whether the regulations should address the fact that firms' income may fluctuate between policy years and a spike in income which may necessitate an increase in the minimum amount of insurance required. This is the way the regulations currently operate, and generally, we do not experience significant negative feedback. Therefore, we are not proposing any changes to this process under the new arrangements.

### **Insurer Appetite and Capacity**

Based on preliminary conversations with insurers, brokers and our own market advisers, our view is that these changes should not cause participating insurers to exit the accountancy market completely nor will the changes have a detrimental impact on the availability of insurance for ICAEW firms. It is our understanding that each individual insurer assesses their own appetite periodically and will consider a range of factors, indeed, we already enter contractual arrangements with insurers on an annual basis and sometimes we find that insurers join or exit the programme due to their own individual criteria.

The biggest anticipated challenge from these changes is the potential impact on premiums as we acknowledge this will be the primary mechanism insurers can use to manage their exposure (given the minimum terms reduce insurers' ability to change the terms/amount of cover). However, based on our understanding of the way ICAEW firms structure and purchase cover compared with the minimum requirements we believe that it would only be a small number of firms that may experience a minimal increase to premium as a direct result of these changes (which is separate from the impact of market forces or the usual factors which could increase a firm's renewal cost e.g. receipt of a claim).

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<sup>10</sup> Any one claim cover provides insurance up to the full limit for each individual claim made in the period of insurance; compared with aggregate cover which provides cover up to the full limit for all claims made in the period of insurance.

## Potential increase to premiums

The preliminary feedback received from ICAEW's insurance advisers is that the change to the upper limit of indemnity will only increase insurer exposure for claims that exceed £1.5m and that generally firms purchasing minimum limits tend to be smaller with little incident of these large claims. We acknowledge that insurers may contend that the increase in limit should result in a premium increase. However, we think that insurers willingness and ability to charge a higher premium will be tempered by market conditions for the insured. The firm would also benefit from a higher level of cover for larger claims which should also reduce the likelihood of underinsurance.

We are proposing that, if a firm does not pay the run-off premium, then insurers would not be able to cancel the policy, which will ensure that after a firm ceases the firm will automatically receive six years of cover. We do expect this to increase the cost of cover in some cases, as insurers are likely to factor in the potential recoverability of the run-off premium into the initial cost of insurance. However, we understand from our discussions that the default rate for ICAEW firms is not significant. In addition, we have also sought to minimise this impact by requiring a total aggregate cap on cover across the six-year period which should reduce the impact on any premium increase.

Insurers are in a stronger position when compared to the consumer to prevent firms from arranging a high excess or be in a position to pursue a firm for unpaid excesses. Therefore, we consider this change to have a positive impact on consumer protection and strikes the right balance in given these considerations.

### Assessment of Impact Questions

- 26. What are your views on our assessment that the proposed changes will have a positive impact on consumer protection? If you do not agree with our assessment, please explain why.**
- 27. Do you consider that any of these changes will have a detrimental impact on a firm's ability to obtain insurance which complies with the PII regulations? If you do, please can you explain your reasoning and provide any alternative solutions.**
- 28. Please provide any additional comments on the changes we are proposing to the PII arrangements?**

## Equality, diversity and inclusion (EDI)

We have considered whether there are any specific risks for EDI purposes and we have not identified any adverse impacts.

Our view is that the proposed changes increase public protection for consumers across all communities. We also think that the changes will maintain a good level of protection for ICAEW firms of different sizes.

We welcome any feedback in relation to this analysis and intend to consider EDI impacts through our continued monitoring activity and will ensure that we continue to consider any changes to EDI impacts as the project continues.

**29. Do you agree with our analysis of the potential impacts of the changes? If not, what other information do you think we should consider?**

**30. Are there any other challenges or barriers that we have not identified, and we should consider further? Please provide an explanation and if available, any evidence which supports your view.**

**31. Are there any alternative options to our PII arrangements that we have not identified that we should consider further? Please explain why and provide any evidence that supports this view.**

**32. Please indicate which category best describes you:**

ICAEW small firm (fee income less than £800,000)

ICAEW medium firm (fee income over £800,000)

ICAEW large firm (fee income over £50m)

Insurer

Broker

Consumer/client

ICAEW member- not in practice

Professional Body/Other regulator

Other- please specify



## TIMELINE & RESPONSES

### How to respond

You can respond to this consultation online.

Or write to us with your response at FAO Sarah – Jane Owen, Professional Standards Department, Metropolitan House, Avebury Boulevard, Milton Keynes MK9 3FS.

This consultation closes on **8 December 2023**.

We will then consider all the feedback and received, discuss the results with the PII Committee and IRB and make any resulting changes as appropriate. A summary of the results will be published early in 2024.

Please contact at [sarah-jane.owen@icaew.com](mailto:sarah-jane.owen@icaew.com) or +44 (0)1908 546 238 if you have any questions about this consultation or need anything further to enable you to submit your response.

## SUMMARY OF CONSULTATION QUESTIONS

The key questions we would like to discuss with stakeholders, including areas which we would value your feedback, are summarised below:

### Limited of indemnity and permitted excess

1. To what extent do you think the proposed changes to the minimum limits provide an appropriate minimum level of cover for an ICAEW firm? Please explain your answer.
2. Do you agree with our proposed approach that the required insurance arrangements (in terms of the required limit and permitted excess) should all be linked to a firm's gross fee income? If not, what measure would you propose?
3. We are proposing to increase the minimum level of cover from £100,000 to £250,000. What factors, other than the impact on price, should be taken into account when we assess this policy change?
4. Do you agree that the higher of £2,500 or 3% of a firm's fee income is the correct calculation for the maximum aggregate excess permitted for firms? If not, what do you consider is an appropriate measure / metric? Please provide your reasons.
5. What are your views on the proposal that firms with fee income over £800,000 may apply defence costs to the excess? Should this choice be available for all firms, or just those that meet certain size-related criteria?
6. To what extent do you agree that giving firms more flexible options regarding defence costs and the excess will potentially lower insurance costs?
7. What are your views on the proposal that in the event of a firm's insolvency any unpaid excess should be met by the insurer?
8. Do you think that that an insurer should also be required to meet the excess if the firm fails to pay within 3 months?
9. What action, if any should be taken against a firm that fails to pay the excess within this period (e.g. automatic cancellation of cover, disciplinary action, accelerated monitoring visit etc.)
10. Do you consider that shifting the insolvency risk could have a negative impact on pricing, capacity or insurer appetite? Please provide details to support your response.

### Compound arrangements

11. Do you think the factors used to assess whether a group can be treated as a compound firm are appropriate? If no, please provide feedback including any alternative factors which should be used.
12. What are your views on how many of the proposed criteria a firm would need to demonstrate in order to be a compound firm?
13. Do you have any other comments regarding compound firms and permitting multiple entities to be insured under a single policy? If you are part of a group we would also like to hear whether you think this guidance is easy to apply to your situation.

## **Large firm threshold**

- 14. What are your views on moving from a large-firm threshold based on a firm's number of principals to one based on a firm's gross fee income?**
- 15. Are there any factors to consider when defining the term 'gross fee income' that will be used to determine if a firm, or group of firms, exceeds the proposed £50m threshold?**
- 16. Do you agree we have set the large-firm threshold at the right level? Yes/No If not, what alternative threshold would you propose and why.**
- 17. Are there any situations where a firm should be permitted to place qualifying insurance with a captive insurer? If yes, please can you provide details.**
- 18. In your view, what should a qualitative assessment of a large firm's PII entail?**

## **Run-off proposed changes**

- 19. What are your views on the proposal to increase the run-off period for ICAEW firms that cease to six-years?**
- 20. We are proposing that the minimum terms offer automatic run-off cover that is non-cancellable for non-payment of premium, do you think this change should be introduced even if this increases the premium in some cases? If not, why not.**
- 21. Do you agree we have reached the right balance between adequate consumer protection and the availability/potential impact on price of run-off insurance under the proposed new arrangements? If not, please explain your reasoning and what alternative option you consider more appropriate.**
- 22. Do you think the use of formula for specifying up-front the calculation of how the run-off premium would be calculated (if run-off is required) is appropriate? If not, what issues could this create and can you explain what you think should be an alternative option.**
- 23. Are you in favour of us amending the obligation on members ceasing to be in public practice to remove reference to 'best endeavours' and instead use 'reasonable steps' to ensure they are covered by appropriate arrangements which satisfy the PII regulations? If not, please provide details of your concerns and outline any alternative solutions.**

## **Dispensations**

- 24. How could the existing process to make an application for dispensation be improved or streamlined? Do you have any comments or feedback we should consider when re-drafting the guidance to Appendix B in the PII regulations?**
- 25. Do you think that ICAEW should charge firms an application processing fee for making an application for dispensation?**

## **Assessment of Impact Questions**

- 26. What are your views on our assessment that the proposed changes will have a positive impact on consumer protection? If you do not agree with our assessment, please explain why.**

- 27. Do you consider that any of these changes will have a detrimental impact on a firm's ability to obtain insurance which complies with the PII regulations? If you do, please can you explain your reasoning and provide any alternative solutions.**
- 28. Please provide any additional comments on the changes we are proposing to the PII arrangements?**

**Other questions**

- 29. Do you agree with our analysis of the potential impacts of the changes? If not, what other information do you think we should consider?**
- 30. Are there any other challenges or barriers that we have not identified, and we should consider further? Please provide an explanation and if available, any evidence which supports your view.**
- 31. Are there any alternative options to our PII arrangements that we have not identified that we should consider further? Please explain why and provide any evidence that supports this view.**
- 32. Please indicate which category best describes you:**

ICAEW small firm (fee income less than £800,000)

ICAEW medium firm (fee income over £800,000)

ICAEW large firm (fee income over £50m)

Insurer

Broker

Consumer/client

ICAEW member- not in practice

Professional Body/Other regulator

Other- please specify

## OTHER USEFUL RESOURCES

The following links may provide additional useful information when considering your response to this consultation:

ICAEW's insurance requirements are currently set out in the following:

- [ICAEW's PII Regulations](#) set out the insurance requirements for members and firms, including details of the terms of cover, for example, the level of insurance required, the maximum permitted excess, who can provide insurance, as well as guidance about the role of the PII Committee and in which circumstances firms are permitted to hold non-compliant cover.
- [The Minimum Approved Wording](#): This sets out the policy wording that ICAEW compliant policies must comply with and sets out the minimum conditions for cover, obligations regarding notification as well as permitted exclusions. Firms are permitted to have cover which is more favourable, but this wording provides a minimum level of protection for firms and consumers.
- [The Assigned Risks Pool \(ARP\)](#): This is for firms unable to obtain PII in the open market and provides emergency cover for a period of up to two years so that firms can continue to practice. The ARP is underwritten by participating insurers and can be viewed as fund of last resort.

ICAEW's PII requirements for members and firms are overseen by the Professional Indemnity Insurance Committee and the ICAEW Regulatory Board (IRB). A summary of the key responsibilities of the PIIC can be [found here](#).

## APPENDICES

1. ICAEW's Professional Indemnity Insurance Regulations effective 1 June 2023
2. ICAEW's Minimum approved wording effective 1 September 2021