



# ***Update on project to review PII Regulations***

## **STATUS**

1. The report is confidential as it relates to developing policy considerations.

## **EXECUTIVE SUMMARY**

2. This paper provides an update on the project to review whether [ICAEW's PII Regulations](#) are fit for purpose and ensure protection of the public at a sustainable cost to the profession.
3. The Call for Evidence stage of the agreed plan has been completed and the PII Committee has considered the results and formulated some recommendations for change to the PII Regulations with others still under consideration. The early recommendations are set out in this paper for discussion and will be developed, subject to the IRB's views, alongside further recommendations ready for the IRB to consider final proposals at its September meeting before a public consultation takes place in October/November.

## **RECOMMENDATIONS**

4. The IRB is asked to provide input on the early recommendations made by the PII Committee arising out of the Committee's review of the response to the Call for Evidence.
5. The IRB is asked to indicate whether it is content for the PII Committee to continue to work with PSD staff to formulate final proposals for the IRB to consider at its September meeting or whether it wishes to form a Task & Finish Group to review the final recommendations from the PII Committee prior to the September meeting (a public consultation will need to take place soon after the IRB September meeting in order to keep to timetable of changes in 2024).
6. The IRB is asked to approve the classification of the paper as confidential.

## **CALL FOR EVIDENCE**

7. The PII Committee has previously identified the following key areas to be considered as part of the PII Review Project (referred to in this paper as the 'review objectives'):
  - a) How much insurance should firms have, and how should the amount be calculated/vary depending on firm size etc?
  - b) How to address use of captive insurance/very large commercial insurance programmes?
  - c) What run-off cover should be required for firms ceasing to trade?
  - d) Arrangements and qualifying conditions for dispensation.

8. A Call for Evidence was launched in April 2023 to gain a better understanding of issues faced in the insurance market. The Call for Evidence was structured with two main strands;
  - a) an online PII survey questionnaire that sought views from a broad range of members;
  - b) a series of targeted meetings with key stakeholders.
  
9. The [PII survey](#) closed on 30 June 2023 with a total of 59 responses being received. While this was a relatively small sample, the feedback on current PII regulations included:
  - Around half of respondents felt that the current PII regulations are appropriate for their businesses.
  - The biggest PII challenge for respondents related to price.
  - The majority of members felt the current limit of indemnity was either appropriate or too high.
  - Almost all respondents felt the term ‘principal’ was easy to understand.
  - Over half of respondents felt that gross fee income should be used to calculate the excess.
  - The majority of respondents felt that the current run-off requirements provide sufficient protection to the public.
  
10. In addition to the online survey, targeted interviews have taken place with a range of brokers, insurance underwriters and firms. A standard set of questions formulated by the PII Committee were discussed during each interview. The feedback from these interviews can be summarised as follows:
  - a) Most interviewees were of the view that the current arrangements generally worked well and that ICAEW firms were able to purchase compliant insurance at a level they desired
  - b) There was a general preference to “keep things simple” and to minimise the number of changes made to the current arrangements
  - c) It was agreed generally that the ‘50 principal rule’ was outdated and should probably be changed.
  - d) Interviewees liked the sliding scale in relation to the required limit of indemnity being at different levels for ‘small’ and ‘large’ firms, but several commented that the minimum limits had been in place for some time and queried whether they should be increased.
  - e) Nearly all interviewees thought that the type of work a firm performs is relevant for determining the amount of insurance required. Many respondents thought this calculation should be determined by a firm and its broker and agreed that, usually, firms put in place cover above the minimum required by the PII regulations usually on an ‘any one claim basis’.

## **PII COMMITTEE REVIEW OF FEEDBACK**

11. In the limited time available to it since the Call for Evidence closed, the PII Committee has formulated some proposals for change in relation to the ‘50 principal rule’, the minimum limits of indemnity and how the permitted excess should be calculated. These are set out below.

12. Recommended changes relating to the third and fourth review objectives, relating to run-off cover and dispensations, will be considered at the PII Committee taking place on 13 July 2023.
13. We have also had periodic dialogue with ICAS and CAI (who share some of the PII arrangements) as part of the review project, including during the Joint PII Meetings and the Joint Advisory Panel (which is also attended by lead insurers). Both bodies have also shared the survey with members for feedback. We are planning to discuss the proposals with both bodies once the PII Committee has finalised its recommendations for all of the review objectives.

## INITIAL RECOMMENDATIONS

### General

14. The PII Committee recommends that the '50 principal rule' is abolished and 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 50 principals. These larger firms will instead be subject to qualitative assessment on whether their insurance arrangements provide adequate cover for potential claims.
15. In addition, the Committee recommends that the minimum limit of indemnity and the permitted excess should also relate to a firm's fee income and that the minimum limits specified in the regulations, which have been set at the same level since 2008<sup>1</sup>, should be increased. It recommends not applying a "scientific" increase to the limits (for example in line with inflation<sup>2</sup>) as this did not address the concern that the lower limit was insufficient. The Committee felt that the proposed figures (set out below in specific proposals) could be tested in the consultation and that it should request the market's response to these proposals regarding capacity and price, particularly in relation to smaller firms as well as the overall public interest impact.
16. The PII Committee has also discussed whether 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. The PII Committee considers this would be a valuable consumer protection tool but is wary of the impact on pricing, capacity and appetite.
17. The Committee also considers that the PII Regulations should make clear that firms should not be able to put in place qualifying insurance with a captive insurer.

### Specific

18. The Committee recommends that the following should also form part of the public consultation:
  - The minimum limit of indemnity should be increased, so that generally, firms will be required have a **£2million aggregate 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.
  - If a firm's gross **fee income is over £50m** they are classified as a "large firm". Large firms are not required to put in place qualifying insurance but they should have reasonably

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<sup>1</sup> 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.

<sup>2</sup> Applying the Bank of England's [inflation calculator](#), the lower limit of indemnity would increase to £154,966 (compared to £100k in 2008) and the upper limit to £2,324,490 (compared to £1.5m in 2008)

appropriate insurance for their exposure to risk which should be qualitatively assessed in some way.

- Defence costs will continue to be in addition to the limit of indemnity.
- 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).<sup>3</sup>
- 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 **3% of the firm's fee income**.<sup>4</sup>

## POTENTIAL IMPACT OF CHANGES

19. The new proposals mean that 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.

20. 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.

The PII Committee requested data about the number of firms that may be impacted by these changes. ICAEW staff produced a report based on the firms' most recent ICAEW Annual Return [REDACTED] but based on those statistics, the impact would be:

Type of Firm	Approx. number	Impact
Over 50 principals	[REDACTED]	Currently these firms do not need qualifying insurance. Nearly all have fee income of over £50m apart from [REDACTED]. [REDACTED] these firms are part of a group and could be classified as a compound firm under the PII Regulations so are unlikely to need to change their insurance arrangements.
Firms with 40 – 50 principals	[REDACTED]	[REDACTED] of these firms report fee income over £50m and would under the recommendations become 'large firms' and will no longer need qualifying insurance but would be subject to qualitative assessment.
Firms with over £50m fee income	[REDACTED]	While [REDACTED] of these firms report having less than 50 principals, they would become 'large firms' and would not be required to have qualifying insurance but would be subject to a qualitative assessment. Again, a number of these entities are part of the same group and may constitute a compound firm and, if so, they are unlikely to need to change their insurance arrangements

<sup>3</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).

<sup>4</sup> Currently firms are permitted to have an aggregate deductible of £30k x number of principals

Firms with fee income between £800,000 and £50m	[REDACTED]	These firms would need qualifying insurance but would be permitted under the new recommendations to have more flexibility with defence costs that could be applied to the excess.
Firms with fee income of less than £40,000	[REDACTED]	Currently firms with fees of less than £40,000 are required to have the minimum limit of £100k which would increase to £250k under new proposals. Note that some of these firms may already purchase insurance above the minimum limit.
Firms who currently purchase less than a £250k aggregate limit	[REDACTED]	Generally, only around 5% of firms purchase cover on an aggregate basis. There are around [REDACTED] firms who currently report having a policy with an aggregate limit of less than £250,000 so will be required to increase the limit of these policies under the new proposals.

21. Most firms opt to take insurance on an “any one claim basis”<sup>5</sup> which provides more cover to the public than the regulatory requirement for aggregate limits and many firms will purchase limits above the minimum. [REDACTED] feedback on the impact of pricing will be sought during the consultation and consideration will need to be given on the potential for future ‘hard market’ conditions.

22. [REDACTED]

23. It will be important to consider feedback received from the market regarding the proposed changes relating to capacity, impacts on premium and the viability of the Assigned Risks Pool (which will have to offer insurance on the same basis as ICAEW’s minimum terms). We will proactively seek the views of lead insurers regarding these matters and set up additional meetings if appropriate. The impact on consumer protection should also be considered and ICAEW intends to target consumer groups.

## CASE STUDIES

ICAEW [REDACTED], has prepared some case studies to demonstrate how the changes may impact firms of different sizes and income. We have provided realistic scenarios which reflect the fact that most firms purchase insurance well in excess of the minimum limits of indemnity [REDACTED].

	Principals	Fees	Current Limit	Proposed Limit	Current Capped Excess	Proposed Capped Excess	[REDACTED]
Firm A	1	£80k	£200k	£250k	£30k	£2,400	[REDACTED]
Firm B	8	£1m	£15m	No change as >£2m	£240k	£30,000	[REDACTED]
Firm C	5	£6.2m	£7.5m	No change as >£2m	£150k	£186,000	[REDACTED]

<sup>5</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.

Firm D	30	£52m	£100m	Large Firm- no required minimum	£15k per claim	Large Firm- Uncapped	[REDACTED]
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24. Firm A has **1 principal** and its fee income was **£80,000** last year. It currently has a policy limit of £200,000 in the aggregate and a £1,000 each and every claim excess. Under the new proposals this firm will have to increase the limit of indemnity to £250,000 and the maximum excess would also be reduced to £2,400 (on an aggregate basis). This policy is likely to be viewed as a very low limit for PII insurers. Therefore, the changes to the limit and excess are unlikely to be material, particularly when the frequency of claims is expected to be low for a firm of this size. A significant part of the pricing will relate to the fixed costs of issuing therefore there may be a minimal increase to the firm's premium of approximately 5%.
25. Firm B has **8 principals** and generates fees of **£1m**. It has an insurance policy with a limit of indemnity of £15m in the aggregate and an excess of £10,000 each and every claim capped at a maximum of £240,000 in the policy year. The first £1.5m of cover is provided in accordance with ICAEW's minimum terms. Under the new arrangements, the firm would now need to obtain qualifying insurance for the first £2m of cover and the maximum aggregate excess would reduce to £30,000 (being 3% of its fees) although the per claim excess would remain. Firm B could also now structure the excess so that it applies to defence costs. Firm B will likely have to structure its policy so the primary layer stretches to £2m which may result in a modest price amendment of around 0-5%. The change in the aggregate excess is unlikely to be material to pricing but could impact insurer appetite depending on the areas of work undertaken by the firm and potential for exposure to high frequency claims.
26. Firm C has **5 principals** and fee income of **£6.2m** per year. It currently has a policy providing cover for £7.5m any one claim with an excess of £15,000 each and every claim (which would be capped at £150,000 per year). The firm would not need to make any changes to its arrangements under the new proposals (the limit of indemnity is over the required minimum of £2m and the maximum permitted excess would be £186,000). However, it could now choose to permit the excess to apply to defence costs which may result in a reduced premium.
27. Firm D has **39 principals** and fee income of **£52m**. It has a programme of insurance with a limit of £100m; the primary layer of insurance of £3m is provided by participating insurers. The excess is £15,000 per claim. Under the new arrangements Firm D would be classified as a large firm so could choose its own insurance arrangements which would be subject to qualitative assessment. Firm D may choose to keep the insurance arrangements the same or could choose to have different insurers with a different policy wording for the primary layer.

## ASSESSMENT OF COMPLIANCE BY LARGE FIRMS

28. At the moment, for the firms with 50 or more principals, the PII Regulations provide that they are not required to hold qualifying insurance (because 50 x £30k excess equates to the current minimum limit of indemnity for qualifying insurance) but that those firms are still required to "take reasonable steps to meet claims arising from being in public practice" (regulation 3.1(a)). Discussions have taken place between PSD and the FRC since 2016 as to where responsibility should lie for the assessment of adequacy of the insurance arrangements for PIE audit firms. The issue was that the PII Committee held responsibility for ensuring compliance of all audit registered firms with the PII Regulations and the responsibility for checking eligibility criteria for



audit registration (which include compliance with the PII Regulations) was delegated to ICAEW in the 2016 Delegation Agreement. However, under SATCAR, the FRC took over responsibility for carrying out whole firm procedures' reviews at PIE audit firms [REDACTED].

29. The Committee has suggested [REDACTED] that the 'larger firms' should be subject to a qualitative assessment moving forward. [REDACTED].
30. [REDACTED] Consideration will need to be given as to how the PII Committee will be provided with a qualitative assessment of the adequacy of these firms' PII arrangements if they are exempted from taking out qualifying insurance.

## NEXT STEPS

31. The timetable now being followed for completion of this project is as follows:

Time	Action
April- June 2023	ICAEW conducts call for evidence
20 July 2023	Provide update to IRB at their meeting on proposals formulated by PII Committee.
July/August	PII finalise recommendations and ICAEW prepare consultation document. ICAEW meet with FRC to discuss large firms and PII
August 2023	Provide update to ICAS and CAI on general proposals for re-draft and obtain feedback.
Early Sept	PII Committee and ICAEW finalise consultation document.
20 September 2023	IRB meeting- present consultation document.
October/ Nov 2023	Issue public consultation on draft PII regulations – consultation to be open for 8 weeks.
December 2023 / January 2024	Review responses to consultation and reflect on feedback received. Liaise with ICAS and CAI as necessary.
December 2023	PII Review Sub-Committee meeting to consider consultation responses
December 2023 / January 2024	Instruct external legal advisors to provide input on redraft of the PII regulations and regulations
January 2024	Report to PII Committee and IRB with update following consultation
Feb-May 2024	Finalise proposals and apply to relevant oversight regulators and boards for approval of amended regulations.
June 2024	Renewal packs including new arrangements issued to insurers.
1 September 2024	Revised PII Regulations come into force.

32. ICAEW staff are collaborating with the PII Committee to finalise its recommendations and begin preparation of the consultation document during July/August 2023 in conjunction with the Irish and Scottish Institutes. ICAEW will also arrange a meeting with the FRC to discuss the potential for qualitative assessments of large firms' arrangements.
33. The consultation document will be presented to the IRB at its meeting on 20 September 2023 and the public consultation will take place in October and November 2023. ICAEW intend to

instruct external legal advisors to provide legal input on the re-drafting of the regulations following feedback received from the consultation.

- 34. Once approval from oversight regulators and internal boards has been received, the new contractual documents will be issued to insurers around June 2024 with a view to coming into force in September 2024.
- 35. The IRB is asked to consider whether it wishes to create a Task & Finish Group now to review the final recommendations ahead of the consultation document being reviewed by the whole board on 20 September (given the need to move quickly after that meeting) or whether the creation of a Task & Finish Group should be postponed until later in the year where, due to the dates of the IRB meetings and the current schedule, there may be a need to review the impact on the consultation feedback on the proposals with the PII Committee before instructing lawyers to draft new regulations.

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