ifaforum

PROTEAN RISK

Winter 2017

Professional Indemnity insurance market update

In June 2016, Protean Risk published an in-depth survey of the Professional Indemnity insurance (PII) market for Independent Financial Advisers (IFAs). This report considered the market outlook, shared insights about emerging claims trends and identified risk management improvements that would encourage insurers to provide the best PII terms.

As we move toward the end of 2017, we have taken the opportunity to consider the accuracy of the predictions, whether the risk management advice remains relevant and provide an updated insight into the IFA PII market.

Before getting in the main part of this update we feel inclined to begin by taking a moment to reflect on recent media coverage and the Financial Conduct Authority (FCA) review. As you will be aware this all stems from a broader review of the Financial Services Compensation Scheme (FSCS), the IFA levy and whether the FSCS are paying claims which should fall into the PII market.

Attention has mostly focused on the level of PII cover available and whether there should be some form of 'minimum terms'. It is an interesting concept and whilst we can see benefits, there is concern that this could cause insurance costs to rise. If minimum terms are set at a higher level than insurers currently offer then some may withdraw from the market, with the remaining markets putting up premium rates.

We are aware that the FCA have spoken with some of the leading IFA PII insurers, gathering views and data to inform their final decision. It is difficult to predict the outcome but we wait anxiously, ready to react and advise our IFA clients.

We would like to see more consistent and dependable Financial Ombudsman Service (FOS) decisions. It has been widely reported that IFAs and insurers find FOS

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Robo advice

Robo-advice is the use of automation and digital techniques to provide financial advice and execution service. This has been identified by the FCA as a solution to the 'financial advice gap', although they have been trying to ensure that the distinction between advice and guidance is clear.

There are mixed opinions about this among IFA PI insurers, with some being more active than others, but we have seen a greater understanding develop over the last 12 months. The main exposures are from potential systemic risks created by algorithm, consumers misunderstanding the nature of the service and unsuitability. Although it is still evidently early days we would expect this sector to continue to develop over the next 12 months. ■

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decisions difficult to predict and there have also been instances where retrospective announcements by the FCA have led to the emergence of new and successful claims against IFAs. Insurers fear similar actions could increase their risk exposure in areas such as defined benefit (DB) transfers, which is why we are seeing an increasing number of exclusions being applied.

Professional Indemnity rates

The market has moved in line with the survey prediction with premiums overall remaining stable, although there have not been any notable new insurers entering the IFA PII market. However, there are a few new insurers that are willing to look at IFA PI insurance on a case by case basis and they may be considering increasing their involvement.

This has translated into a two-tier market with many IFAs considered to be lower risk experiencing stable rates, but those engaging in higher risk activities or that have suffered notable claims facing a less straightforward renewal processes.

Our survey listed DB transfers, insistent clients, Unregulated Collective Investment Schemes (UCIS) and tax mitigation products as the main high-risk activities and it is clear that this remains largely unchanged.

One market development of note is the acquisition of Collegiate Management Services by AmTrust Europe Limited in November 2016. Both specialise in IFA PI insurance, with Collegiate also providing outsourced claims management services for a number of other IFA PI insurers.

Insurance covers increasingly on an IFAs radar

CYBER

This year has witnessed a number of high profile cyber attacks on businesses of all types and according to the New Model Adviser, the FCA received 78 reports of cyber-attacks on financial advice firms in 2016. With the personal data they hold, IFAs are increasingly exposed to hackers and ransomware and we have seen an increase in claims emanating from scam emails where instructions are given to the IFA by email to transfer funds. In one recent case the client had £250,000 transferred from her investment bond due to her email account being hacked and this resulted in a complaint against the adviser that went to the FOS.

Many IFAs have taken steps to improve their IT security systems to protect themselves and their clients from cybercrime and there is significantly greater interest in Cyber insurance. Although some PI policies offer a degree of cyber coverage, standalone and specialist insurance offers more comprehensive protection and is relatively inexpensive. Cyber insurance cover can include protection against data breach, privacy policy failure, for regulatory defence and penalties, website content and public relations management expenses.

Whilst the insurance cover is valuable, many buyers are more attracted by the provision of first-response services such as computer expert, legal and notification services ensuring that any loss emanating from a data breach is mitigated as much as possible.

DIRECTORS' AND OFFICERS' LIABILITY

As the operating environment continues to become ever more complex for managers in a financial regulated company we are seeing a marked increase in enquiries for Directors' and Officers' Liability. Managers are becoming more and more exposed to making errors, whether that is from adhering to compliance regulations, dealing with the FCA or keeping up with best practices for corporate governance and risk management. They are increasingly at risk from being personally liable for those losses and the cost of any resultant investigations.

IFA Directors' and Officers' Liability insurance is relatively inexpensive and protects managers from claims which may arise from the decisions and actions taken within the scope of their regular duties. It pays for defence costs and financial losses, as well as providing cover for costs arising from administrative and criminal proceedings, or in the course of investigations by the regulator or criminal prosecutors. ■

DB transfers

Two years since the Pension Freedoms were introduced, the industry has been dealing with an unprecedented number of individuals seeking to transfer away from their DB scheme - as estimated 80,000 transfers having taken place between 1 April 2016 and 31 March 2017. Continuously in the press, there is talk of general uncertainty in the PII market especially as there appears to be an ever-increasing level of scrutiny by the FCA on this activity.

In June 2017, the FCA published a consultation paper proposing a range of new measures intended to protect the number of people seeking to transfer by setting out steeper requirements on advisers and modernising the transfer value analysis process. As part of this the FCA has been assessing firms on their DB transfer business and visiting firms. A policy statement on this is expected to be published in 2018.

With uncertainty about the future and the number of claims potentially emanating from this activity, insurers remain uneasy and are choosing to be very cautious as to the level of transfers that they are prepared to cover. Some IFAs are, therefore, finding it increasingly difficult to get cover or facing increased premiums, excesses and exclusions. Insurers are still prepared to cover this activity and it is up to the individual firm to work with their insurance broker to ensure that the internal procedures of advising on DB transfers are clearly presented at renewal

Self-Invested Personal Pensions (SIPPs)

There has been a marked increase in SIPP related claims over the last couple of years, a fact confirmed in the FOS figures for 2017. These relate to advice given by financial advisers to move pension savings out of existing pension arrangements and deploy them in other investments within SIPP wrappers.

The FSCS has reported that SIPP claims have increased by more than a third over the last year and this is mainly because a considerable number of the firms involved have since failed. Many of these firms would have had a large exposure to illiquid investments and most likely exclusions in their PII policies or increased excesses.

Insurers have highlighted these focus areas:

1. Concerns are surrounding the underlying investments being too high risk and potentially unsuitable for the investor – with the potential for PII claims should the investment fail and become illiquid.
2. Issues arise when the IFA has not advised on the underlying investment, just the SIPP on an execution only basis. Recent FOS decisions show that they consider the regulated firm as having a duty to advise on the suitability of the underlying investments, as well as the transaction itself.
3. More and more IFAs are acquiring customers from unregulated introducers or lead generators. An FCA alert was issued last year expressing concern that these introducers are influencing advisers to switch clients' pensions into high risk products. The regulated firm must maintain control and input into the advice that they are ultimately responsible for giving to customers, and this again has come to the fore as a result of the increased demand following pension freedoms.

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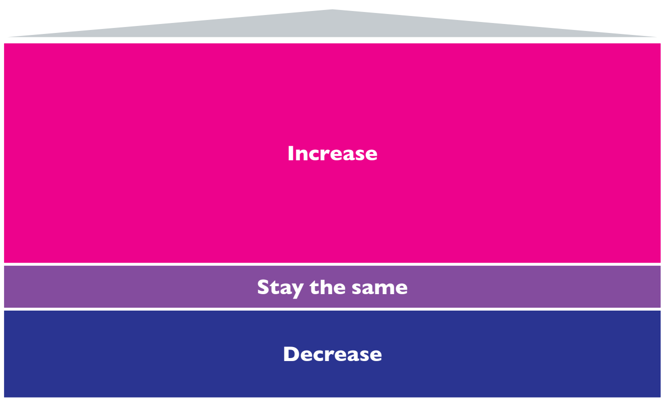
Peer to Peer Lending

Consumers being able to seek recourse to the FOS and FSCS in relation to Peer to Peer (P2P) Lending has raised interest in this area. Considerable numbers of providers have launched P2P products in recent years specifically to the adviser market, but advisers remain wary. It is important that advisers understand the risk of any investment and advises the client in accordance with the suitability requirements

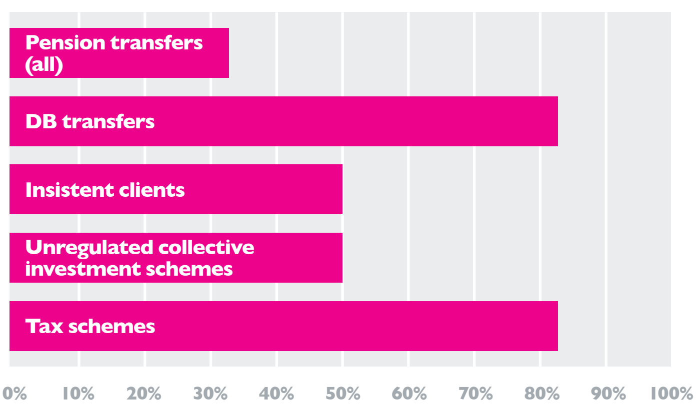
Research published by Intelligent Partnership in December 2016 revealed just 9% of advisers expect the Peer to Peer sector will form part of their advice process in the next 12 months. One third of respondents had never heard of Peer to Peer despite the fact that according to the University of Cambridge the UK online lending industry has grown significantly since 2014.

There seems to be a 'wait and see' attitude from the market in general and this is reflected with PI underwriters.

Expectation of IFA PI claims notifications in the next 12 months



Percentage of respondents giving their top three risk concerns



Source: IFA 2016 PI insurance market investigation

Case Studies

SECTION 166

A firm which had recently undergone a Section 166 had cover refused by their current insurer just a few days before renewal. Through lengthy conversations with the insured we gained a thorough understanding of the level of information required during S166, how they had rectified the issues and the implications for the future. The time we spent and the detail we gathered enabled us to successfully negotiate terms with an insurer providing the cover the firm needed and a competitive premium.

UCIS COVER REQUIREMENT

A firm had conducted a high amount of UCIS and needed cover for this activity. We were able to work with them to capture all the information insurers required, particularly demonstrating the strict internal procedures when advising clients. This reassured insurers and we were able to tailor a programme to cover this activity.

POLICY CONSOLIDATION

A larger financial adviser group had multiple policies with different insurers. We reviewed these arrangements and designed a more streamlined solution with one insurer, reducing excesses and costs and extensively improving levels of coverage. Having one insurer eliminated potential gaps in the cover in the event of a claim.

LONG-TERM RELATIONSHIP

A firm stipulated that they wanted to engage with the insurers at a more strategic level to build a long-standing relationship. We facilitated meetings between various team members and the insurer at the client's office to develop a strong understanding and promote the relationship. We believe meetings with insurers should be encouraged as this direct engagement creates a depth of trust and understanding and often leads to more competitively priced policy with higher levels of coverage. ■

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Claims

We were surprised to note that almost two thirds of those underwriters surveyed in 2016 expected claims notifications to increase. On one hand, many underwriters recognised the impact of the financial crisis finally receding and the value of increased risk controls within IFAs to reduce the potential of claims. On the other, an increasingly litigious environment, pension freedoms and the potential for further thematic reviews by the FCA were the main reasons that many of the respondents felt that there would be an increase in notifications over the next 12 months.

In fact, according to the FOS, complaints against IFAs have actually dropped in the last year. There has also been a reduction in the percentage of the numbers of upheld complaints which is a positive development and hopefully is a continuing trend. ■

About the Author

Julian Brincat specialises in IFAs and has over a decade of insurance experience working for leading brokers. Having graduated with a BA (Hons) in Politics and Economics, Julian undertook his legal qualifications which contributes to his in-depth understanding of insurance wordings.

Other publications available at www.proteanrisk.com:

- **2017 IFA PI Buyers Guide**
- **IFA Claims Best Practice**
- **IFA PI Insurance 2016 Market Investigation**
- **IFA Professional Indemnity Review Matrix**

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PROTEAN RISK

Broker at LLOYD'S

About Protean Risk

Protean Risk is a specialist insurance broker advising firms in the investment industry, financial services and technology sectors. Clients range from start-ups through to companies with revenues in excess of £100m.

We are fast emerging as one of the leading IFA PI brokers in the UK. Unencumbered by the commitment to schemes and facilities, Protean Risk has access to one of the widest available choices of IFA PI insurers including Lloyd's markets. We work closely with the Association for Professional Compliance Consultants (APCC) and have participated in insurance steering groups which have included the Financial Conduct Authority (FCA) and the Financial Ombudsman Service (FOS).

Underpinning our values as a company is an overarching focus on customer service and satisfaction, borne out by extensive client testimonials and client retention rate. In a client survey over 90% of respondents rated our service as 'good' or 'excellent' and recommended us as 'experts in their business sector'.

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