

CHAPTER 13

PROFESSIONAL INDEMNITY INSURANCE AND ITS ROLE IN COMPLAINT PROTECTION

By Neil Pointon and Robert Bass, PYV LTD.

1. Introduction

Mortgage Intermediaries (MIs) were required to carry Professional Indemnity (PI) Insurance under the rules of the Mortgage Code Register of Intermediaries (MCRI), which subsequently became the Mortgage Code Compliance Board (MCCB). These requirements included a minimum limit of indemnity of £100,000 any one claim or £500,000 in the aggregate. The maximum excess they could carry was £10,000 and, at this time, a minimum premium of £249 (including IPT) was available with a nil excess.

On October 31st 2004, Mortgage Day (or 'M-Day') occurred and the FSA took over the regulation of MIs. This resulted in some MIs deciding to abandon their independent status and became 'introducer appointed representatives', or Appointed Representatives (ARs) whilst others quit the industry. This was due to the worry that the FSA's rules would be too onerous for smaller firms. This meant that the number of individual firms requiring their own PI policy reduced substantially as the ones that became ARs were able to obtain cover via their principal's or network's group policy.

The reduction in the number of potential clients increased insurer competition for this class of PI business and improved market conditions including increased insurance capacity has meant rates being regularly reviewed, resulting in today's minimum premiums being below £200 in some cases. Nil excesses are less prevalent these days, and a £2,500 excess is common for certain areas such as commercial mortgages, equity release and self-certificated mortgages.

2. Current PI Cover Requirements

The FSA's requirements regarding professional indemnity insurance did not alter much. Basically those with net tangible assets of less than £1,000,000 had to maintain PI cover with a minimum Limit of the higher of 10% annual income or £100,000 any one claim or £500,000 in the aggregate (subject to a minimum upper Limit of £1,000,000).

Many mortgage advisers also provide general insurance cover and this area of activity was regulated by the FSA in January 2005 as a result of the Insurance Mediation Directive's enactment; imposing a minimum limit of indemnity of the Sterling equivalent of 1,000,000 Euros any one claim or 1,500,000 Euros in the aggregate or, if higher, 10% of their annual income up to £30,000,000.

It is usually possible to arrange one policy to cover both areas of activities and higher limits may be advisable. Many firms find it helpful to use the services of a specialist PI Broker.

3. Excess and Capital Adequacy

For a firm which does not hold client money or other client assets, the excess must not be more than the higher of

- a) £2,500 and
- b) 1.5% of annual income

For a firm which holds client money or other client assets the excess must not be more than the higher of

- a) £5,000
- b) 3% of annual income

Any firm that wishes to (or has to) carry higher excesses than those above will need to provide additional capital. Those who have an exclusion of cover for any activity that they carry out will need the consent of the FSA who will decide the basis upon which it is to be granted.

Please see the FSA Handbook

<http://fsahandbook.info/FSA/html/handbook/MIPRU/3/2> for full details.

4. Threats and Opportunities

Unlike the IFA PI market, so far, there have been no major problems (such as the pension review, splits and precipice bonds) which have actually resulted in mass claims notifications against this sector, also bearing in mind that endowments are regulated investment products which pure mortgage intermediaries are not authorised to advise on. There have, however, been concerns raised regarding self-cert mortgages and the sale of payment protection insurance (PPI) but, as yet, claims activity involving MIs remains low.

Perhaps the biggest threat to this tranquillity is the state of the housing market. If there were to be a significant 'correction' to house prices or a 'crash', then this might be the time for people to look around for scapegoats, fairly or falsely, to blame for their over investment in property as a class, whether commercial or private.

Any bad press, coupled with a volume of notifications could have the effect of hardening the MI PI market overnight, making cheap premiums, (certainly sub £200 premiums) a thing of the past. For comparison, it is worth noting that the

starting premiums for small IFA firms are around £2,000 but it has also been much higher at around £5,000.

Other potential problems to be aware of include future regulatory reviews; especially those that seek to use the benefit of hindsight and today's revised standards when judging the work of the past. We should also look at the bigger picture. The hurricanes and catastrophes of 2005 put a large dent in worldwide insurance capacity with hurricane Katrina alone estimated by some to cost over 40 billion dollars. While it may be thought this has nothing to do with the rates an MI pays for his PI, if insurance capacity diminishes as a whole or alternatively the available capacity flows from PI to another field which underwriters believe will produce greater returns, then we will enter a hard market.

Factors which might more directly affect the MI PI market include; potential concerns regarding equity release and PPI; the implementation of MIFID in November 2007; any introduction of home information packs, regardless of their content, may have PI implications for those that wish to get involved, especially any MI who is contemplating employing their own home inspectors.

All these factors may affect the capacity available and therefore the premium that firms pay. It is important to be aware that if premiums fall below a level which is sustainable when balanced against actual claims experience, there will inevitably be a rebound reaction and premium hikes.

For the time being though, MIs can enjoy benign market conditions where premiums are sometimes lower than they were in 1999, despite claims inflation which should affect all classes of PI business. Therefore, there is still the opportunity to seek a better PI deal.

5. What protection does Professional Indemnity Insurance provide?

Professional Indemnity is designed to protect firms financially in the event of a claim from a client who has suffered a financial loss as a result of negligent acts, errors or omissions being made by the Insured, subject to policy terms and conditions.

PI Insurance is of vital importance to MIs considering the changing regulatory landscape, coupled with the increasingly litigious nature of our society. It is imperative that MIs implement the right PI policy.

A plethora of insurers offer PI cover but not so many offer bespoke solutions for MIs. The extent of protection varies enormously, as does the cost and the level of advice and after sale service on offer. MIs who choose their PI provider based on price alone may find they are not covered when a claim occurs.

When purchasing PI cover it is important to ensure the business has adequate cover and it is important to ensure that the firm compares like with like and not 'apples and pears'. The cheapest policy is not always best; particularly when it transpires that there are significant gaps in cover. Also, the widest protection need not always cost the most. A good indicator that a firm is on the right track is if it is asked to complete a proposal form which is specific to the mortgage intermediary profession.

When purchasing PI, the following questions should be considered:

What makes for a compliant policy?

MI's should ensure that they choose a policy that is FSA compliant or they may find themselves unprotected and vulnerable to regulatory action. It is important that your policy provides protection against awards made by the Financial Ombudsman Service.

No policy will fund fines imposed by the FSA, but some policies do benefit from automatic inclusion of legal costs to defend claims arising from falling foul of the FSA rule book where a matter may lead to a claim from a client.

Does the policy provide fully retroactive cover?

For established businesses, policies must provide fully retroactive cover i.e. protection today for unknown claims emanating from mistakes made in the past.

This is particularly important when an MI opts to move Insurer. Otherwise, the MI could find the business uninsured for mistakes from past activities, should they give rise to a claim.

Is the policy a civil liability wording?

So as to ensure they have the widest possible protection MI's should opt for a policy which affords a civil liability wording. Failure to do so may mean that the MI is not adequately protected against all aspects of the Financial Services and Markets Act 2000 and other legislation and associated regulation.

Are all possible defence costs covered?

It is important to check that the firm's policy also includes the cost of defending claims as well as any resultant damages. The scope of defence costs provided is not consistent across the insurance market. By way of example, some policies may not cover legal representation costs at disciplinary hearings.

Are dishonesty, libel and slander and loss of documents cover included?

Comprehensive cover should automatically embrace such protection at no extra cost. MIs should check their policies afford such protection.

Can general insurance activities be included within the same policy?

MIs who have a general insurance arm need to ensure they get a sympathetic hearing from their PI provider. Not all PI providers appreciate the nuances of general insurance and as a result such MIs are finding themselves unduly penalised and have unreasonable premium loadings applied.

Are reversionary mortgage and equity release activities covered?

Not all Insurers are prepared to cover reversionary mortgage or equity release activities. Thus, unless the MI chooses his PI broker and insurer wisely he could find at best, heavy premium loadings or cover restrictions being applied, or at worst, no cover available at all. Thus, it is important to provide full details to your Broker about such existing or potential activities and choose a PI policy that is sufficiently flexible to embrace all current and potential new business activities.

Is there adequate run-off cover for past activities?

MIs who have ceased certain aspects of their work should not omit to disclose this year on year to their Insurer otherwise the MI could face finding itself uninsured for claims coming out of the woodwork relating to previous activities. A full disclosure of past activities is even more important in the event the MI opts to change insurance provider.

Are special needs for multi-faceted businesses catered for?

As dedicated IFAs and MIs are not bound by identical mandatory requirements, MIs who have an IFA arm have the option to arrange a separate policy to cover their IFA activities, or combine all activities under one roof. Combining all activities under one policy will not always result in a premium saving and may compromise the scope of protection. Thus multi-faceted businesses should turn to a specialist broker who understands the specialist needs of both MIs and IFAs to facilitate its insurance programme, so as to receive expert advice and guidance on how to construct the best possible value for money insurance programme in line with the firm's risk profile and specialist cover requirements.

If the firm is an appointed representative (AR), what should it expect in terms of PI insurance from the Principal?

ARs should either arrange their own run off cover or ensure their Principal has arranged run-off cover for any of their past activities prior to joining the principal or network. Otherwise, the AR may face insolvency in the event he is unable to meet his liabilities should a claim occur relating to previous activities.

ARs are also recommended to enquire about the excess on the Principal's policy. It may well be that the AR would be required to fund claims falling within the excess, which could be significant and it may be possible to negotiate a more appropriate level of excess.

6. Where to go to get a quote

When choosing a PI Broker firms should ensure they have access to:

A market leader in PI insurance for MIs (and IFAs and general insurance if the firm has an IFA and/or General Insurance Broking arm) who fully understand the nuances and the diverse nature of all aspects of MI activities, and who is fully conversant with the specialist insurance needs of MIs.

A dedicated team of experienced specialist MI PI technicians on hand to provide expert timely advice as and when needed.

Specialist guidance when claims or potential claims occur and the handling of all connected issues, thus relieving the MI of unnecessary stress and administration.

It is important for you to check cover is placed with quality rated insurers, bearing in mind the collapse of some insurers involved in writing PI business.

A broker that also has access to a MI specific scheme which has a tailored proposal form and policy wording available will help to ensure the firm is in the right place.

7. How to reduce cost

Firms that are able to demonstrate a proactive approach to risk management will be considered a better risk by insurers. Taking a higher excess or reducing cover is not always the best solution. Good record keeping and having fully documented files is a must and will help in the long run.

8. Where do claims come from?

The reality of the matter is that claims can come from a host of unexpected areas as well as the more obvious sources. As an adviser, the key to successfully defending a complaint is to keep ahead of the game by maintaining records in excellent order and endeavouring to anticipate problems wherever possible.

Notwithstanding these measures, clients can and do complain, rightly or wrongly, if they believe they have reason to do so. A number of possible areas where claims can come from are outlined below:

8a. PPI Policies

A number of high-profile fines (and ensuing business reviews) have been imposed by the regulator in 2007 and there seems to be the likelihood of many more in the offing as the FSA have openly and repeatedly expressed their concerns over PPI sales. The likelihood of a review along the lines of the pension review appears remote, but individual advisers may find themselves having to review their book of business and to make redress payments where necessary.

The main issues are that many policyholders may not appreciate the cover is optional or have sufficient understanding of the limitations of the cover. An adviser needs to be very careful to explain and document all exclusions and draw attention to all pertinent facts in order to defend a complaint.

8b. Fraud

An adviser needs to be very careful to ensure the party he is dealing with is all they say they are. From the client who exaggerates his income on a self-cert mortgage (which can lead to affordability issues) to simply checking the identity of a client, fraud is a significant problem for insurers. For example

An adviser was approached by a client who required a substantial further advance on the mortgage he had arranged jointly with his wife some years previously. He attended the adviser's office alone to do the groundwork and subsequently signed the necessary documents on his own. His wife's signature was required on the final document and he said she would come in later, during her lunch break. Some hours later a lady appeared in the adviser's office when the principal was out and signed the papers. The advance was paid over to the account specified. Some while later the adviser was contacted by a very concerned lady who was unable to understand why her mortgage repayments would be increasing so much. It seems her husband had recently left her and had gone to live abroad with a lady friend, taken the money with him and left her the debt.

8c. Income Protection (PHI) and Term Assurances

These may seem to be the easiest of policies to arrange but, by their nature, they can result in the costliest claims. Sums insured on death cover are generally significant and any claim can be difficult to defend. A client needs to understand exactly where they stand with the status of their cover, especially if there is a delay during the underwriting period. The client must not form the impression they are on cover until they actually are and they should not cancel any existing policies until they are satisfied that the cover is in place and clearly understand (and accept) any differences in cover. The duty to disclose any pre-existing

conditions, where an obligation, must also be pressed upon the customer if a costly error is to be avoided.

8d. Mortgage advice

There are a number of potential pitfalls for the adviser. Most would result in modest claims but the long-term aggregation cost can be damaging to the business. These include:

- **Early redemption charges:** the costs must be clearly explained, considered and documented to avoid disputes at a later date.
- **Delays in processing applications:** these should be avoided wherever possible. If delays are unavoidable the client should be kept fully informed. The loss of a property due to delays in mortgage processing could result in a claim for lost or additional fees incurred or even a revised valuation of the property.
- **Economic factors:** though outside the control of an adviser these will inevitably have an effect. In the current climate house prices are rising, but so are interest rates. If a house price collapse occurs, as has been predicted in some quarters, close attention will be paid to mortgages and their affordability. A downturn could expose inadequate advice, or borrowers who struggle financially and may decide to blame the adviser, and the adviser may find themselves having to justify his recommendations.

Ultimately it comes back to the same principle: know your client and document everything.

About PYV Limited

Based in the City of London, PYV Ltd is the market leader in the provision of professional indemnity insurance to Mortgage Intermediaries, IFA's and other professionals as well as related specialist financial products. PYV is an independent, Lloyd's accredited broker regulated by FSA.

PYV employs expert staff with a wealth of knowledge and experience. Many are long serving, highly trained, individuals which provides the base for ensuring continuity of client service and building long-term mutually beneficial commercial relationships with their clients.

Five of PYV's Financial Services Team has been with the company for over 15 years. The experience they have gained is incomparable with other brokers.

PYV arranges professional indemnity cover for clients of any size from the smallest sole trader to the largest life offices in the country. Every client is a valued customer and receives the service they deserve.

PYV arranges cover for most professions including solicitors, architects, surveyors, life offices, accountants, mortgage intermediaries, financial advisers, bailiffs, buildings inspectors, engineers, surveyors and insurance brokers.

PYV is not tied to one market/insurer and has access to the entire insurance market. They have exclusive facilities with a number of insurers which allows them to obtain beneficial terms for their clients which are unavailable elsewhere.

PYV's Chairman was Deputy Chairman of Nasdim and involved in promoting professionalism and the highest standards within the Financial Services industry well before the Financial Services Act 1986 made it compulsory.

PYV's claims team have over 90 years combined experience in handling claims for IFAs and a wealth of experience in a variety of other professions.

PYV are proud to have been sponsors of AMI and AIFA Leaders of Industry Lunches.

PYV are part of the OFEX listed PYV Group. Established over 30 years, PYV Group employs over 80 staff and has a strong reputation built around its pension and protection expertise.

Further information is available at www.pyv.co.uk or call 0207 626 6789.

Neil Pointon

Neil Pointon (aged 40) was educated at Loughborough Grammar School and came in to the insurance business when he joined the claims department of the General Accident Insurance Company in Leicester in 1985.

2 years later, he joined the family insurance business when he went to work for Pointon York in Leicester (an IBRC registered broker) as an account handler/technician looking after all types of general insurances.

In August 1989 he was posted to the Group's Lloyd's brokerage, Pointon York Voss Ltd (later to become PYV Ltd) to help deal with the Professional Indemnity (PI) account which had just been won from FIMBRA, a forerunner to the Financial Services Authority (FSA). This was originally supposed to be a mandatory scheme to place cover for every Independent Financial Adviser (IFA) firm in the UK (over 8,000 firms), however, in October 1989, the decision was changed and the scheme became voluntary.

Despite this set back, PYV quickly established itself as the Market Leader for this type of policy and Neil has spent the last 18 years specialising in PI and associated covers. During this time there have been many challenges, not least the Pension Review and other financial product concerns, but also the rules and requirement brought in by the formation of the MCCB and the implementation of Mortgage Day and the subsequent implementation of the Insurance Mediation Directive (IMD) in January 2005.

He has worked his way up through the ranks and his knowledge and PYV's market standing have been recognised by him being invited to be a member of various important industry PI working parties and panels, including the FSA's.

He progressed to become a director in 1997 and succeeded his father as Chief Executive of PYV Ltd in 2005.



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