Professional Indemnity Insurance : Neil Pointon, Chief Executive, PYV Ltd

PYV'S 2008 REPORT ON THE STATE OF THE PROFESSIONAL INDEMNITY MARKET FOR MORTGAGE INTERMEDIARIES

Professional Indemnity Insurance (PI) has been high on the agenda for mortgage intermediaries since the arrival of the Mortgage Code Register of Intermediaries (MCRI), which subsequently became the Mortgage Code Compliance Board (MCCB).

On October 31st 2004, Mortgage Day (or 'M-Day') occurred and the FSA took over the regulation of mortgage intermediaries. This resulted in some intermediaries 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 those 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 minimum premiums last year being below £200 in some cases.

Unlike the IFA PI market, up until the emergence of tighter credit restrictions, there have been no major problems in the last 15 years (such as the Pension Transfer 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 some types of payment protection insurance (PPI), lifetime and home reversion schemes but, as yet, claims actively involving mortgage intermediaries 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 advisers, fairly or falsely, to blame for their over-investment in property as a class, whether commercial or private.

The current bad press, however, coupled with an increased volume of claim notifications could have the effect of hardening the mortgage intermediary PI market overnight, making cheap premiums, (certainly sub £500 premiums) a thing of the past. For comparison, it is worth noting that the minimum premiums for small IFA firms are around £2,000 but it has also been much higher at around £5,000.

The credit crunch, whilst being considered by some to be an almost global threat, is expected to cause a wave (some might say a Tsunami) of claims against those UK professional advisers with direct involvement in financial and property markets. The reasoning is obvious as when prices fall, people face losses on their investments and look for someone else to blame. Whether these allegations are converted into successful claims against an adviser's PI policy will depend on individual circumstances, although defence and administration costs are likely to have been incurred, regardless of the outcome. Those who have kept full documentation to

demonstrate the client was fully informed of the details involved and that the advice was suitable will be best placed to defend themselves and keep their own costs down. This potential for increased claims activity was sure to force PI insurers to take another look at their exposure and they are actively revisiting the terms that they are offering (if any).

In addition to this, all mortgage intermediaries that also carry out General Insurance activities will be affected by the Euro's rise against the Pound as the minimum Limit of Indemnity they are required to hold was set by the Insurance Mediation Directive (IMD) in Euros. The IMD requires firms to carry minimum limits of 1 million Euros for any limit that is on an any one claim basis and 1.5 million Euros for any limit that has an aggregate cap, which is the market norm. Please note, these limits need to satisfy this criteria only at the inception of the policy. In the recent past, this equated to purchasing sterling limits of £700,000 and £1,050,000 respectively but for cases incepting in early April 2008, the exchange rate requires that these sterling limits be increased to at least £800,000 and £1,200,000.

Other areas of specific concern to providers of mortgage intermediary PI include potential exposure to equity release and mortgage fraud claims and the potential for any future regulatory reviews. The effect of European financial advisers taking up capacity following the introduction of MiFID on 1st November 2007 has yet to materialise, where as last year's floods have already impacted some UK property insurance programmes with rate increases being common.

We should also look at the bigger picture. The hurricanes and catastrophes of just over two years ago put a large dent in worldwide insurance capacity at the time with hurricane Katrina alone expected by some to cost a total over 86 billion dollars. You may think this should have nothing to do with the rates a mortgage intermediary pays for his PI, however, 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 this could cause conditions to harden. As it turned out, the reverse happened last time with new fresh capital being drawn in chasing after the expected (and achieved) healthy returns from a hard market specific to US property catastrophe rates. This, however, would not necessarily be the case again if we were to see a return to the same level of hurricane activity as 2005 in the future. The last two years' benign conditions have caused this market to soften dramatically with the 01/01/08 reinsurance season reporting increased exposure being taken on for lower premiums. If the current capacity were to be subsequently exhausted by new large catastrophies who is to say whether new fresh capacity will come in, especially bearing in mind the worldwide tightening of available money associated with the credit crunch.

All these factors may affect the capacity available and therefore the premium that is paid. Whilst it is understandable that any firm which has received better terms at their past renewals would wish that this trend continues, it is also important to be aware if premiums fall below a level which is sustainable when balanced against actual claims experience, there will inevitably be a rebound reaction which will favour no-one.

With so much uncertainty and so many variables to consider, it is important to seek a deal with partners (both brokers and Insurers) who will be there for you in the long run. That is why it is important to use a specialist broker who knows the market inside out and has access to all relevant underwriters to provide security for the long term. They should also be able to provide an up-to-date knowledge regarding PI matters concerning a specialist industry. Check to see whether your broker has access to

mortgage intermediary specific PI facilities and a tailored proposal form and wording. Consideration should also be given as to whether you have access to a broker's own claims department that has the experience in handling mortgage intermediaries claims and is there to work exclusively on your behalf. After all, protection in the event of a claim is ultimately what you buy the cover for.

In conclusion, in recent years it has been a highly competitive market, favourable to Mortgage Intermediaries. With the changing economic environment, PI conditions have already become more challenging, making your choice of PI provider even more important than ever before. PI could be about to rise even higher on many mortgage intermediaries' agendas.

PYV's Claims Director, Robert Bass, has set out below information regarding some early 2008 topics from the claims arena which I am sure you will find of interest.

PPI Policies: a number of high-profile fines (and ensuing business reviews) were 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.

AMI's Director Richard Farr believes it's also worth mentioning though, that mortgage intermediaries in a competition commission report came out as representing the lowest risk in this industry with a significant majority of policy holders understanding what cover they had and understood any limitations to cover.

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. If a house price collapse occurs 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 their adviser, and the adviser may find themselves having to justify his recommendations.

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