MARCH 2023

A review of ICAEW’s Professional Indemnity Insurance Requirements

SUMMARY OF CURRENT REQUIREMENTS

1. Insurance requirements for ICAEW members, regulated firms and other entities

Professional Indemnity Insurance (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).

Firms which are within scope of ICAEW’s regulations have a duty under ICAEW’s PII Regulations to take reasonable steps to meet claims arising from public practice. As part of this, 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’(see below);
- 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).

Resources

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 (PIIC) and the ICAEW Regulatory Board (IRB). A summary of the key responsibilities of the PIIC can be found here.

2. Level of insurance cover

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 an excess 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"). Compliance by the largest firms with the PII Regulations is monitored by the FRC's Audit Firm Supervision team as part of its 'whole firm' procedures.

Within the PII Regulations "principal" is defined as "a sole practitioner, partner, director or member (of a limited liability partnership) of a firm". The PIIC has issued guidance that only statutory directors/members should be counted for the purposes of the calculation (as opposed to salaried partners, senior management etc in some firms).

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

Compound Arrangements

PII Regulation 3.8 and 5.3(c) deals with the potential for "compound firms" and acknowledges the use of insurance for group arrangements. Previously, the PIIC previously 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.*
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> *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;

Run-Off Cover

Requirements for run off 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). Run-off cover may be provided under the policy of a continuing practice or you may need to take out an individual policy. ICAEW's minimum terms (see clause D4) dictate 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.

3. <u>Who can provide insurance coverage?</u>

Qualifying insurance must be provided by a 'participating insurer', which is an insurer that has contracted with ICAEW to provide cover in accordance with ICAEW's requirements. A participating insurer agrees to provide coverage which complies with the minimum approved wording and agrees to include a difference in conditions clause within its policy wording. Participating insurers also underwrite the Assigned Risks Pool.

<u>Captive Arrangements</u>

Larger firms (with 50 or more principals) are permitted to put in place their own insurance arrangements (see 50 principal rule above) and some of the large firms have cover in place with offshore captives which may provide cover for the firms' global networks or have large excess/deductibles or hold insurance with non-participating insurers. A captive insurer is a regulated insurance entity that is capitalised in full by the parent company. It may be considered as a form of self-insurance with decisions in relation to the captive being taken by the captive's board.

4. <u>Inability to obtain qualifying insurance</u>

The Assigned Risks Pool is an "insurer of last resort" and is available for firms that are unable to obtain PII in the open market. It provides emergency cover for a period of up to two years so that firms can continue to practise whilst they try to source qualifying insurance. Cover in the ARP can be expensive and firms are required to pay a deposit premium before cover is incepted.

In exceptional circumstances, the PIIC 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 PIIC 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.