Consultation on proposed changes for professional indemnity insurance (PII) run-off in the UK

1 Introduction

1.1 Background

1.1.1 When an RICS regulated firm or individual ceases to trade, it is required by RICS to have 'adequate and appropriate' professional indemnity insurance (PII) run-off cover.

1.1.2 Run-off cover is recognised as an important tool for protecting consumers, as it provides certainty that any loss incurred over that period will be covered by insurance.

1.1.3 RICS recommends a period of six years for PII run-off but instructs regulated firms to seek the guidance of their broker on an appropriate period for the specific range of services offered by the firm.

1.1.4 Run-off is usually provided by the last incumbent PII insurer of a firm, though this is not a mandatory requirement.[1] Run-off cover has not been available through the Assigned Risks Pool (ARP), except at the discretion of prescribed insurers where a firm closes while in the ARP.

1.1.5 We are now determining what changes, if any, should be made to the PII run-off requirements of regulated firms that are de-registering from RICS Regulation and ceasing to trade.

1.2 Development to date

1.2.1 A call for information about the market and any risks was launched in December 2016.

1.2.2 This information formed the basis for an open consultation, which reviewed five different proposed options for addressing the issues identified in run-off availability and consumer protection. In total there were 24 responses from the surveying profession, insurers and a financial institution. The full report can be found in the Appendix at the end of this consultation paper.

1.2.3 The main emerging themes across the responses were:

- there is an issue of availability of run-off in the market;
- the profession would welcome clearer run-off requirements from RICS beyond 'adequate and appropriate';
- the profession would also welcome a run-off option that gave them assurance of cover, independent of paying annual premiums;
- any requirement that is too onerous on insurers will cause some of them to exit the market, driving prices up and availability down; and,
- there is no apparent direct evidence of consumer detriment resulting from firms without sufficient run-off at present.

1.2.4 After considering the responses, the RICS UK and Ireland Regulatory Sub-Board decided to open the ARP to offer a standard PII run-off package. In addition the Sub-Board also considered the proposals set out in section 4, and decided to consult on these. The purpose of extending the ARP and consulting on these proposals is to minimise the risk of consumers, particularly vulnerable consumers, being left unprotected.

1.2.5 We met with a number of insurers to understand and assess the impact of the proposals highlighted in this consultation. These meetings suggested that the insurance market could work with these changes.

2 Consultation

2.1 This consultation forms the final part of our policy development process, to ensure that the impacts of any policy change have been properly assessed. This will help us develop a final position that is proportionate to the problems it is intended to address.

2.2 The range of policy options being considered has been narrowed by careful examination. The aim of this consultation is to gather information about a single proposed change to the existing PII policy in the UK, in the context of an expansion of the role of the ARP to offer run-off.

2.3 The purpose of this consultation is to:

- fill information gaps that remain despite previous reviews;
- help us to determine whether the proposed change will successfully address availability of run-off cover and consumer protection considerations; and,
- collect feedback on the impacts of the presented change, particularly from insurers and the profession.

Next steps

August-September 2018	Consultation with insurers, firms and consumer groups.
November 2018	Decision from UK and Ireland Regulatory Sub-Board on final PII policy changes.
April 2019	Launch of amended ARP, offering run-off for those unable to procure in the open market at a reasonable cost.

How to respond

2.4 Please respond to this consultation no later than 30 September.

2.5 You can respond to this consultation by either answering the questionnaire here or by sending responses to:

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12 Great George St London
SW1P 3AD
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3 Identified problem

3.1 As part of the call for information, we asked insurers for details on the length of time between claims being made and when the work was carried out. The data received showed that claims were brought consistently over the first six years following the closure of a firm, reflecting the most commonly applicable statutory claims limitations.[2]

3.2 In light of this, RICS considered whether or not the requirement to maintain PII for an ‘adequate and appropriate’ amount of time after closure offers consumers enough protection.

3.3 The current RICS approach is to advise firms to consult with their broker to determine what an ‘adequate and appropriate’ timeframe is, consistent with the wider professional indemnity market. Our discussion with brokers indicated that a prudent broker would advise a period of at least six years. Longer may be necessary in some cases, depending on the type of work a firm has undertaken and the point at which the complainant was made aware of the problem.

3.4 However, as the onus is on the firm, there is no certainty that such advice will be obtained or that run-off will be maintained for that period. While RICS firms are required to provide evidence of a run-off policy upon closure, we are limited in our ability to monitor firms after that time.

3.5 This suggests that six years3 would be an appropriate period to clarify adequate and appropriate cover, and a mechanism would be required to ensure that cover was taken over the full six-year period.

4 Proposed solution

4.1 Following discussions with stakeholders, including insurers, we propose to define the minimum level of cover firms must take when going into run-off as:

- six years in duration;
- fully prepaid;
- on a claims-made basis (i.e. cover period overlaps with when the claim is made, not when the work is completed); and
- £2 million aggregate limit, £500,000 of which to be ringfenced for consumer claims and claims by corporate entities with an annual turnover of less than £2 million.[4] In line with the policies of other professions, we have also decided to cap individual claims to a maximum limit of £500,000.[5]

4.2 RICS will still require firms to ensure they have adequate and appropriate run-off cover reflecting the size, nature and services offered by the firm, but the above will be the minimum requirement to comply with the Regulatory Board's policy.

4.3 The firm may continue to obtain run-off from the open market of approved insurers, as is currently the case, or they may approach the ARP.

4.4 The package offered by the ARP will also be in the above terms. No other terms will be offered by the ARP, although terms that exceed those specified may be offered via the open market. Should the terms offered not fulfil the characteristics of 'adequate and appropriate' cover, the firm will need to seek cover that satisfies this requirement elsewhere.

5 Impact assessment

Summary of impacts

5.1 If we implement this proposal, there will be additional requirements on firms, as they will be restricted to having a prescribed minimum amount of PII run-off at the point of deregistration. The prepaid nature of this policy will have a further financial impact, as all costs would be prepaid in this proposal, unlike in the past where annual premium payments would spread out the cost over the life of the policy. The one-off cost is estimated to be equal to 150-200% of the last annual PII premium. We consider this resolves the issue of non-payment of premiums during a six-year period. Market insight also suggests this would be the most cost-effective option and achieves the desired balance between affordability and assurance.

5.2 Insurers will be required to take on a greater pooled risk (though not necessarily risk overall) through the ARP. Feedback from insurers suggests that this should not significantly impact their costs. Insurers with a larger proportion of the PII market for surveyors will have proportionally more risk through the ARP, although there will be a minimum of 1% of total risk for every firm, in line with the existing ARP structure.

5.3 The current role of the ARP will be diversified and expanded. The new function will not be a tool to improve the risk exposure of firms, as it will not include the ability to consultatively manage risk towards the goal of lower premiums. This is because any firm approaching the ARP for run-off will be ceasing to trade and cannot alter their risk retroactively. Many more firms will be likely to have direct interaction with the ARP when seeking run-off. This may lead to increased demands on the administration of this structure.

5.4 There will be greater assurance for all parties that PII run-off will be both available and in place on prepaid terms, which will negate concerns surrounding annually paid premiums.

5.5 Consumer clients and smaller enterprises will be ringfenced for greater minimum protection than large commercial clients. We have considered that commercial clients are better able to manage risks and retain greater ability to influence terms than consumer clients. The stated minimums will not preclude regulated firms from requiring 'adequate and appropriate' run-off should they have a history of undertaking work for large commercial clients.

5.6 A possible consequence of the higher initial cost for firms would be an increased prevalence of firms that cannot de-register due to the cost, but that are no longer actively trading, which could increase occurrences of disorderly deregistration e.g. due to liquidation. This possibility could devalue the offering of RICS firm regulation as it could be perceived as burdensome to withdraw from.

5.7 We believe the most likely negative impact resulting from these changes is that it could motivate a portion of insurers to leave the overall PII market for surveyors. We estimate that 5% of the smallest insurers might leave the market, but we would welcome views from insurers on this estimate. We would also welcome views on how this may change in adverse market conditions.

Impacts on firms

5.8 Firms will, for the first time have broad access to their preferred form of PII run-off cover through the ARP. This will likely lead to this insurance product becoming more prevalent in the open market as insurers become more familiar with it.

5.9 Firms will need to plan for the financial impact of prepaying for their six-year policy at the point of de-registration. Market intelligence tells us that this value will be 150-200% of their annual premiums when trading. Annual payment of premiums for PII run-off will no longer be possible and this will have implications for those wishing to pay for their run-off over time.

5.10 This policy will remove the flexibility for firms, with the advice of their brokers, to opt to maintain lower levels of run-off cover or to self-insure these risks. While this will be an additional burden on some firms, we anticipate that the pricing of the premium for the run-off policy will reflect the level of risk that the firm represents, and so low risk firms will not face a heavy financial premium.

5.11 Taking the average of the projected range of premiums to be 175% of the annual premium, we have prepared the following examples:

- Firm A are relatively small with a low turnover, low frequency of complaints and/or claims. They pay £3,000 annually for their PII cover. Thus the one-time PII run-off premium = 175%(annual premium) = 1.75(£3,000) = £5250; and,
- Firm B is a large firm with a high turnover and relatively high frequency of complaints and/or claims. They pay £100,000 annually for their PII cover. Thus the one-time PII run-off premium = 175%(annual premium) = 1.75(£100,000) = £175,000.

5.12 Once they have paid the premium and the policy is in place, firms will have assurance that they will have PII run-off cover for six years after ceasing to trade, even in unforeseen circumstances, e.g. death of a surveyor that is a sole-trader. This assurance was seen to be in high demand from the profession in the responses to the previous consultation with almost unanimous preference.

5.13 The cost of PII run-off may act as a deterrent to the practice of 'phoenix firms' in some cases. The term refers to firms closing operations to escape liabilities and then quickly setting up again to continue trading.[6]

5.14 We would welcome comments and views from firms on the impact this may have in your ability to sustainably close.

Impacts on insurers

5.15 These changes may result in some insurers leaving the market, which may have the effect of reducing competition for those that choose to stay involved. We estimate that approximately 5% of insurers, with a relatively small exposure to RICS, will leave the market. A reduction in competition may lead to higher premiums overall. However, discussions with insurers suggest the likelihood of this occurring on a significant scale is low in the case of the proposed changes.

5.16 Insurers will be required to offer PII run-off cover via the ARP to be an RICS-approved insurer. Larger insurers will be proportionally more exposed to risk via the ARP, though there will be a minimum amount of risk that will need to be taken on by insurers (1% of total).

Impacts on consumers

5.17 Consumers will have assurance that PII run-off is in place even if a firm has closed, to the extent of at least six years after ceasing to trade.

5.18 Consumers will have further assurance that if a regulated firm is exposed to both consumer and commercial claims, successful consumer or SME claims will have access to a ringfenced compensation pool regardless of any competing claims from large firms.

Impacts on commercial clients

5.19 The proposals will give commercial clients assurance that all firms regulated by RICS will retain a minimum package of PII run-off up to six years after ceasing to trade, including up to £1.5m for commercial claims.

5.20 It is feasible that, should the policy of a regulated firm pay out £2m in consumer claims, a commercial client may not have access to compensation. That said, we consider they are likely to have the ability to require, as a contract condition, a guarantee from firms that necessary PII run-off arrangements are made to cover any possible claims. RICS would still expect all cover to be 'adequate and appropriate.'

6 Consultation questions

For all

6.1 What impact do you think the proposed change will have on regulated firms closing down sustainably?

6.2 Do you agree with our proposed minimum requirements for run-off cover, i.e. £2m claims limit with £500,000 ringfenced for consumers? Is this the correct structure? Would you suggest any alternatives?

6.3 Will the changes outlined promote confidence in firms and professionals regulated by RICS? Please explain.

6.4 The expansion of the role of the ARP will allow firms more access to their preference as highlighted in the consultation responses, of a prepaid PII run-off package. Can you foresee any negative consequences of this change?

6.5 Is this model fit for purpose in the event of a harder insurance market where policy availability would go down and premiums would go up? If no, please suggest how this could be achieved.

6.6 Our estimate is for a six-year run-off premium to cost 150-200% of the annual premium while trading. Do you agree? If no, please provide an estimate and your reasoning.

6.7 Please include any further comments you have on the proposals below.

For insurers

6.8 If these changes are introduced, will your company continue to offer PII to RICS professionals/firms?

6.9 In your opinion, what impact will this have on the number of insurers in the market?

Endnotes

[1] Insurers have stated that the key reasons for refusing run-off would be in circumstances of a poor claims history (particularly instances of fraud or disciplinary action) or perceived difficulties in paying premiums or excesses.

[2] Negligence claims can have up to a 15-year life span via the 1980 Statute of Limitations Act. However, in many circumstances the limit is six years.

[3] As evidenced by RICS' call for information to insurers.

[4] This figure is based on a doubling of the existing ARP limit (from £1,000,000). Our current ARP manager has recommended that this increase would be enough if run-off was to be included. This was further substantiated by the consultation responses summarised in the Appendix.

[5] This would be in line with recent proposals from the Solicitors Regulatory Authority, both for PII run-off and their compensation fund.

[6] More information on can be found on this here and how RICS manages successor practices is located here.

Appendix A: 2017 professional indemnity insurance (PII) run-off consultation summary

1 Background

1.1 RICS is aware that RICS regulated firms have not always been able to obtain PII run-off easily. If the marketplace will not sell them a policy, or will only do so at an unsustainable cost, this affects the ability of RICS regulated firms to close and cease trading in an orderly way.

1.2 Such concerns led to the removal of the six-year mandatory run-off requirement in the RICS PII policy. The change was made to avoid a situation where members were being forced into a disciplinary process when they had been unable to secure affordable run-off despite reasonable efforts to do so. The 2008 economic downturn was also a factor as it exacerbated the access of firms to the required levels of run-off.

1.3 In 2017, the RICS UK and Ireland Regulatory Sub-Board agreed to carry out a review of PII run-off cover for firms closing or ceasing to trade because of concerns that the existing policy did not give enough certainty and assurance.

1.4 The main aims of this review were to:

- ensure that private consumers are adequately protected; and
- enable regulated firms to close by being able to obtain the run-off cover they require.

1.5 RICS engaged with key stakeholders to help understand the current problems. These activities included:

- 'RICS Professional Indemnity Insurance Run-off Review: Summary of Data Collection': A call for information was distributed amongst the insurance sector to identify knowledge gaps and describe the current practices in the sector.
- 'PII Run-off Review: Call for information': Focused on direct engagement with firms deemed to be most at risk by the policy, representatives from small business groups and key multi-stakeholder groups.
- End Users Survey: RICS commissioned Ipsos MORI to investigate stakeholder views including PII expectations and experience. RICS also approached consumer organisations for insights.

1.6 The information received from these engagements were considered by the Sub-Board and they decided to consult on five options:

- introduce terms to the minimum wording policy that the last insurer must provide at least six years' run-off cover subject to the payment of annual premiums;
- extend the Assigned Risks Pool (ARP) to provide risk cover;
- mandate the incumbent insurer to provide six years' run-off under the minimum wording policy;
- require the incumbent insurer to provide six years' run-off under the minimum wording policy for consumer claims only; or
- create a special purpose fund that covers all run-off for RICS firms.

1.7 Combinations of the above options were also considered.

1.8 The consultation ran for eight weeks, closing on 8 January 2018.

2 Respondents

2.1 In total there were 24 responses to the consultation:

Respondent type	Number of respondents
Firms	8
Members	8
Insurers	7
Financial institutions	1

Table 1: Breakdown of respondents by type

3 General themes in the responses

3.1 There was both first hand and anecdotal evidence of firms encountering difficulties while trying to obtain PII run-off cover.

3.2 No respondent had direct experience of a consumer being negatively impacted by a lack of PII run-off provision, although there was one anecdotal account. However, as we did not receive any responses from consumers or their representative groups, it is difficult to infer too much from this.

3.3 There was a recognition that the status quo is not ideal in terms of both run-off availability for firms and RICS' own requirements of 'adequate and appropriate' cover, which is viewed as being unclear and open to interpretation.

3.4 There was further acknowledgment that the status quo does not address the issue of RICS' restrictions in enforcing run-off requirements post-deregistration.

3.5 There was recognition that all options raise serious questions of affordability for both insurers and the surveying profession.

4 Summary of responses from the profession

4.1 The profession reported that their access to PII run-off is a significant issue. Cost, availability and the requirement of committing to paying annual premiums over several years were all raised as concerns.

4.2 To purchase six years (or similar) of run-off with a single payment at the point of deregistration and/or ceasing of trading was preferred by the profession but was reported to be difficult to obtain from the open market. The trade-off was seen to be that annual premiums might lead to lower costs as no-claims status could reduce premiums over time, but the single payment offered certainty, which was highly-valued. There was an account from an individual who, due to an outstanding claim against a former colleague, was struggling to obtain PII run-off cover until the claim was resolved.

4.3 There was not a strong recognition of the possible consumer detriment stemming from run-off availability, which highlights a general lack of insight into the position of consumers.

4.4 There were mixed views on a staged roll-out of any changes with a preference for an immediate and decisive intervention. This suggests there may be scope for further consultation before a final decision is taken.

4.5 Engagement from RICS on this topic was welcomed and the profession is keen to have clearer requirements and better access to PII run-off generally.

5 Summary of the insurers' responses

5.1 These responses tended towards caution but welcomed clarification of the requirements on firms. Their views were generally consistent from one responder to another.

5.2 Many responses focused on the likelihood of the options to cause some insurers to leave the market due to increased burdens. These were predicted to lead to increased premiums due to reduced competition in the market.

5.3 The idea of a staged response (i.e. beginning with one proposed option and moving in time to another) was unanimously not welcomed by insurers.

5.4 One consultation response presented a separate proposal based on three principles:

- incorporate the cost of run-off cover into a firm's normal PII cover while they are trading;
- make it mandatory that RICS-listed insurers provide run-off cover, in line with the RICS minimum terms; and
- the run-off policy is jointly underwritten by all RICS-listed insurers.

6 The options in the consultation

Option 1 - introduce terms to the minimum wording policy that the last insurer must provide at least six years' run-off cover subject to the payment of annual premiums.	• A firm would be guaranteed to be offered a run-off policy from their last insurer. • It would require them to pay annual premiums over the six years that would likely reduce over time depending on claims made. • This would formalise current practice in the market and increase run-off availability to firms.
Option 2 - extend the Assigned Risks Pool (ARP) to provide risk cover.	• The ARP is a way for risk to be shared across all RICS-approved insurers. This reduces risk for an insurer to indemnify a high-risk firm that they would be unwilling to insure otherwise. • Currently the ARP is used to help firms improve their risk management and find PII when they cannot procure it on the open market. • This option would allow firms to seek PII run-off from the ARP as well as from the open market.
Option 3 - mandate the incumbent insurer to provide six years' run-off under the minimum wording policy.	• The insurer would have to indemnify the firm for run-off whether the firm paid a premium or not. • To cover this cost, the insurer would likely charge a higher premium during the trading life of the firm to pay for the run-off period.
Option 4 - require the incumbent insurer to provide six years' run-off under the minimum wording policy for consumer claims only.	• Consumer claims and commercial claims differ in size, type and related risk. • Consumer claims tend to be smaller and may be easier to insure.

	• This would prioritise consumer protection over businesses, and many will be better educated about the risks involved.
Option 5 - create a special purpose fund that covers all run-off for RICS firms.	• This is the model used by the Law Society of Ireland. • Insurers would pay into it and recoup this cost by raising premiums for firms not in run-off. • Any RICS regulated firm could enter it.

7 The responses to the options

Option 1 - Introduce terms to the minimum wording policy that the last insurer must provide at least six years' run-off cover subject to the payment of annual premiums

7.1 This was broadly seen as protecting consumers, though some responses questioned whether it solved the core reason for their vulnerability, i.e. how to enforce that PII run-off premiums are paid after de-registration.

7.2 Insurers unanimously noted that it would increase costs and decrease availability. Some expressed concerns about whether increased costs of PII outside of run-off would drive more firms towards the ARP as it currently stands.

Option 2 - Extend the Assigned Risks Pool (ARP) to provide risk cover

7.3 The profession viewed this option as strongly supporting consumer protection. Insurers were more mixed in their responses with some underlining that if 'adequate and appropriate' was not to be amended and annual premiums remained the status quo, opening the ARP to provide run-off would not solve the problem. Insurers also underlined that the expenses for a firm entering the ARP would rise with their involvement in the mortgage valuations market.

7.4 On the issue of defending against the practice of 'phoenix firms' it was pointed out that making upfront run-off PII (a single prepayment at the beginning) mandatory, would take away a lot of incentive for the practice.

7.5 As an aggregate figure, £2m being the minimum level of cover required was seen as enough, if extra levels of cover were also possible.

7.6 The estimated cost implications of requiring a prepayment for six years of run-off, as set out in the consultation document (i.e. 100-150% of the annual premium) was seen as accurate by half of the insurers, with the other half suggesting it may be higher (up to 200-450% of the annual premium).

7.7 This option was preferred by insurers with detailed knowledge of the ARP. The inclusion of the ARP could be done on a case-by-case basis in pre-negotiated criteria. In this way it could be separated from the existing activities of the ARP. This process of applying pre-negotiated criteria could consider the claims history of the applicant to set premiums commensurate with the firm's risk profile. Some practical barriers were noted such as overall market conditions and the schedule for when changes could be made to the ARP, i.e. annually from 1 April to 31 March.

7.8 Overall this option attracted the least criticism across responses.

Option 3 - Mandate the incumbent insurer to provide six years' run-off under the minimum wording policy

7.9 The overall response from the profession was that they did not see the advantages of this option outweighing the negatives (e.g. increased cost).

7.10 The profession was concerned that the cost would push run-off out of reach of firms. There were general queries on how the risks of the surveying profession compared to others.

7.11 The view of insurers was strongly negative on this proposal and did not agree that the benefits outweighed the costs. One response suggested small firms would be negatively impacted in this scenario. Insurers did however broadly agree with the projection of what would happen in the consultation document with regards an increase of premiums (70-100% increase).

Option 4 - Require the incumbent insurer to provide six years’ run-off under the minimum wording policy for consumer claims only

7.12 A wide range of definitions for ‘consumer’ were suggested, including those used by other organisations, e.g. SRA/FCA/FOS. One response suggested a consultative approach would be best to establish this.

7.13 The profession noted the likelihood of increased premiums if this option was pursued. There were mixed opinions on whether this would create a separation between requirements on consumer-facing and commercial-facing firms. It was noted that corporate commercial accounts rarely go to small surveyor firms, but at the same time the separation of consumer and commercial claims was seen as likely to polarise the market.

7.14 Most insurers felt this option would have a negative impact as the increased requirements would drive insurers out of the market, reducing competition and therefore potentially increasing premiums overall. Other problems listed were that it does not address commercial claims and may lead to vigorous challenges as to what constitutes a consumer versus a commercial claimant. They did see the implication of carving out the ‘household’ consumer protection as being positive for smaller/regional/non-lender focused businesses.

Option 5 - Create a special purpose fund that covers all run-off for RICS firms

7.15 The profession had mixed views on this option, with broad acknowledgment that it would lead to a less competitive insurance market that would damage PII provision overall.

7.16 The question of how such a model would function in an economic downturn was addressed by both the profession and insurers. Concerns were expressed over whether it would survive a dramatic increase of claims as seen in the 2008 financial crisis.