Jersey Financial Services Commission

# JFSC Professional Indemnity Insurance (PII) Review Results - 2017

The Jersey Financial Services Commission (**JFSC**) issued a press release in March 2017 explaining that it would be undertaking a review of Professional Indemnity Insurance (**PII**) arrangements in place within Jersey's finance industry.

Having adequate PII in place is a regulatory requirement for licensed entities, and this is of particular importance due to the lack of a financial services compensation scheme (other than for Bank Deposits and Recognized Funds[1]) in Jersey. The JFSC has increased its focus on PII arrangements within the finance industry and expects firms to do the same.

In March 2017, JFSC Director of Supervision, Jill Britton commented:

"*PII forms an important part of Jersey's regulatory regime and we are concerned that some local firms may not give sufficient and appropriate attention to ensuring that they have suitable cover in place, or that they adequately understand the terms of that cover. It is essential that firms are able to comply with the terms of their insurance and that policies and procedures are in place, and followed, so that they do not invalidate their cover.*"

The JFSC's review looked at the PII arrangements for a random selection of 50 license holders across the Investment Business, General Insurance Mediation Business, Trust Company Business and Fund Services Business sectors.

This report sets out the results of the JFSC's review and is intended for use by all relevant entities when reviewing and considering the adequacy of their PII cover.

The JFSC would like to thank all firms included in the review for their cooperation and the valuable information provided.

## Breakdown of respondents by sector

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| Investment Business (IB) | 13 |
| General Insurance Mediation Business (GIMB) | 5 |
| Trust Company Business (TCB) | 17[2] |
| Fund Services Business (FSB) | 15 |

## Access to PII cover

During the course of its day to day supervisory interactions with regulated entities, the JFSC has received feedback to the effect that some firms find it difficult to obtain adequate cover for their

[1] These schemes only cover claims arising as a result of the financial failure of a Jersey Bank or the Manager, Trustee or Custodian of a Recognized Fund.

[2] The PII arrangements of one licence holder who formed part of the random selection of TCB entities were deemed not relevant to the review, therefore only 16 responses were considered.

activities. The JFSC therefore sought to clarify the ease with which entities included in the review felt they were able to obtain PII cover. Additionally the JFSC sought to explore how cover was obtained, for example via a broker or directly from the insurer and how long firms had been with their broker and/or insurer.

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| 80%<br>of firms stated that they had found it easy to obtain PII cover | 95%<br>of firms obtained their cover via a broker, the majority of which were UK-based |
| 3 to 10 years<br>The period of time that most firms had been with their broker | 1 to 5 years<br>The period of time that most firms had been with the same insurer |

Three IB, five TCB and two FSB entities responded that they felt PII cover was difficult to obtain. These firms cited reasons such as cover having been withdrawn for certain products which had been subject to historical claims and a limited pool of PII providers willing to provide cover at competitive rates.

## Notifications made to PII providers

As part of the review, respondents were asked to provide details of the number of times they had notified their PII provider of a matter which may result in a claim during the period 1 January 2016 to 16 March 2017. The total number of notifications made during this period, split by industry sector, was as follows:

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| Investment Business | 8 notifications |
| General Insurance Mediation Business | 1 notification |
| Trust Company Business | 59 notifications |
| Fund Services Business | 12 notifications |

The JFSC feels it appropriate to highlight that in all of the policies reviewed, the failure to notify insurers in a timely fashion of matters which could ultimately result in a claim, may result in cover being avoided at a later date. Firms are encouraged to review the terms of their PII policies in this regard and if they are in any doubt to consult with their Broker.

## Claims made by entities against insurance policies

In addition to enquiring about the number of notifications made to insurers, the JFSC also sought clarification of the actual number of claims submitted by the selected firms. Although notifications had been made across all four sectors of the finance industry that were subject to the review, actual claims were limited to two sectors in particular:

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| Trust Company Business | 21 claims |
| Fund Services Business | 6 claims |

## Limits of Indemnity

Each of the Codes of Practice (**Codes**) requires that a firm maintains adequate insurance cover at all times, commensurate with its business activities. With the exception of the FSB Code, the Codes go on to specify a minimum level of cover that firms are required to maintain. The minimum indemnity limit is calculated by reference to relevant fees and commissions or to controlled assets.

The thematic review identified that 15 out of 40 registered persons[3] had obtained PII cover where the limit of indemnity had been set at, or just above, the minimum specified by the Codes. In a number of these cases the JFSC is concerned that, whilst the registered persons are able to demonstrate that the cover meets the minimum required limit of indemnity, the overall level of insurance may not be adequate and commensurate with the size and/or nature of business activities.

The JFSC continues to work with these firms to ensure that the level of cover is adequate. Additionally, the JFSC will give further consideration to the current requirements of the Codes, regarding the limit of indemnity, to ensure that they remain appropriate.

## Reinstatement Cover

None of the respondents to the survey had purchased reinstatement cover. The JFSC noted that some policies provided automatic reinstatement cover as a standard component of the policy.

## Limitations in cover

The JFSC wished to understand whether there were limitations in PII cover, and in particular any limitations which may result in the cover being in breach of the requirements of the respective Codes.

Based on the information reviewed, the JFSC found:

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| 29%<br>of policies contained retroactive dates. Only one such date had been notified to the JFSC in accordance with the requirements of the Codes | 8%<br>of firms did not have cover for Employee Dishonesty, a breach of the Codes |
| 16%<br>of firms falling within the remit of the Channel Islands Financial Ombudsman (**CIFO**) did not have cover for rulings made by the Ombudsman. Whilst not an explicit requirement of the Codes, the JFSC would expect firms to carefully assess the adequacy of their cover where CIFO rulings are not covered. | 8%<br>of firms did not have cover for the activities of contract workers, a breach of the Codes |

[3] Firms licenced solely for the conduct of FSB are not included in this total

In addition to the above, the reviews undertaken by the JFSC identified a number of specific exclusions which could materially limit the levels of cover in place for certain entities. Such exclusions include:

› Claims linked to advice/services provided in respect of Defined Benefit Pension transfers
› Claims relating to the sales of particular investment products
› Claims directly or indirectly resulting from breaches of the AML/CFT Handbook
› Loss of documents as a result of Cybercrime.

None of these exclusions had been notified to the JFSC in accordance with the requirements of the Codes.

The JFSC recommends that firms ensure that an appropriate level of focus is given to exclusions within policies, and where necessary firms should be engaging with their brokers in order to seek the removal of any exclusions which may materially limit their level of cover. The JFSC would ask entities to contact their Supervision Manager in the event that they discover any material exclusions within their policies.

A small number of respondents' policies contained a deductible amount rather than an excess. In all cases, in spite of the presence of a deductible amount, the limits of indemnity were found to be in compliance with the regulatory requirements.

## Matters relating to Group policies

74**%** of respondents were covered under Group policies (including policies providing cover to multiple entities). A number of issues of concern were identified when it came to the PII arrangements of these firms.

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| Six instances were identified where the firm had not been specifically named in the policy, and it was not immediately clear that the firm was covered by the policy | Firms appeared to place significant reliance upon their Group and/or insurance brokers to assess whether cover is appropriate. Whilst brokers owe a duty of care to their clients, the responsibility for the adequacy of cover rests with firms |
| From the responses received, a number of firms did not appear to fully understand the intricacies of the policies and the full extent of the limitations in cover | The JFSC had concerns that the level of indemnity may not be sufficient for a number of Group policies where multiple different claims could be received in a policy year from different group entities |

Where firms are covered by a Group policy, it is incumbent upon the firm itself to ensure that the PII policy under which it is covered is sufficient to ensure that it meets the Jersey regulatory requirements.

42% of Group policies contained exclusions restricting the ability of one entity insured under the policy to make a claim against another (insured versus insured exclusions). The JFSC is working with those entities whose policies contain such exclusions to better understand how these may affect the adequacy of the PII cover.

## Terminology within policies

The JFSC recognises that the majority of firms use UK-based brokers and insurers. A number of the policies reviewed were found to contain UK specific terminology. Of particular note, policies referred to the Financial Conduct Authority instead of the JFSC and the Financial Ombudsman Service rather than CIFO. Where such non-Jersey terminology exists within current policies, firms should seek to clarify the extent of their cover via their broker.

Where no mention was made to a specific Ombudsman body, in some instances the definition of a claim was found to contain wording which would suggest that such rulings would be covered by the policy.

The JFSC's expectation is that firms will scrutinise both draft and final policy documents to ensure that the wording therein is relevant to the jurisdiction in which they are conducting activities, and where necessary request amendments to the wording.

## Procedures relating to PII

The JFSC sought to better understand the procedures that entities have in place with regards PII matters.

Although in practice the process outlined by firms in their responses concerning the obtaining or renewing of PII cover appeared sound, the JFSC was disappointed to find that the vast majority of respondents did not have written PII procedures in place.

The JFSC identified that a number of entities had failed to notify the JFSC of material limitations contained within their policies such as retroactive dates and specific material exclusions, as required by the Codes, which is indicative of a lack of robust procedures.

The JFSC also identified a number of examples of good practice associated with the process followed by several firms and these included:

- Consideration at Board level of the required level of PII cover
- The delegation by the Board, to an individual director, of the responsibility for reviewing the level of cover, assessing its adequacy and whether it is commensurate with the entity's business activities, and reporting their findings back to the Board
- The use of Brokers to compare the limits of indemnity to those of industry peers
- Requiring subsidiary and/or department heads to sign-off on internal forms and declarations used by firms to complete proposal/renewal forms and to make all required notifications under the existing PII policy.

## General comments

Whilst all respondents had cover for the loss of documents in accordance with the requirements of the Codes, the JFSC had some concerns that cover may not extend to electronic documents, and will therefore be looking at this in further detail and if necessary updating the Codes. In the meantime, the JFSC would encourage firms to consider the adequacy of their PII arrangements in this area.

With regard to retroactive dates, the JFSC did have some concerns about policies which had been put in place following a merger or acquisition involving the firm. It was not clear in such instances what cover firms had in place for activities undertaken prior to the merger or acquisition taking place.

A considerable number of policies contained sub-limits, thereby limiting the amount of cover provided by the policies for specific matters. The JFSC did not identify any areas of concern regarding the sub-limits it reviewed, however it would encourage firms to ensure that they are aware of, and comfortable with, any sub-limits contained within their PII policies.

The JFSC has been, and will continue, working with entities who formed part of the review to address any areas of concern with a view to all remediation being completed by the end of 2017.

## Conclusion and next steps

As a result of the work undertaken, the JFSC concluded that five out of the 49 policies reviewed were not in compliance with the requirements of the Codes. In these instances, the JFSC has engaged with firms to ensure that shortcomings in PII cover are rectified, and consideration given to the level of regulatory action required as a result of these breaches.

The JFSC has some concerns about the awareness of directors of the exact levels of cover currently in place, and ultimately their ability to assess whether or not the cover is in compliance with the requirements of the Codes.

With regards to the assessment of the adequacy of cover, whilst the JFSC will consider the PII arrangements of individual registered persons on a periodic basis as part of its normal supervisory processes, it is ultimately the firm's responsibility to undertake this assessment, and to fully understand the cover being provided, including the specific terms and conditions of the policy and any limitations in cover.

Firms need to ensure that notifications are made to the JFSC as required by the Codes, and likewise to their insurers in accordance with the terms of cover. Procedures related to all PII matters should be reviewed and updated as necessary, and where absent introduced.

Cover is very much dependent upon the information provided by the firm to their broker or insurer when completing policy proposal forms. It is therefore of paramount importance that, when negotiating PII cover, firms provide all relevant information about themselves and their business activities to their broker/insurer. Failure to do so may result in inadequate cover being provided and claims being avoided by the insurer at a later date.

The JFSC will be reviewing the current requirements of the various Codes of Practice in respect of PII with a view to enhancing them where necessary.

The JFSC will also review its Guidance Note on PII which was first issued in July 2014, again with a view to making enhancements where relevant.

## Limitations

- The review sample was made up of 50 firms/licence holders. Responses were reviewed for 49 of these, with one licence holder's PII arrangements falling outside of the scope of the review. The sample was selected in order to include a range of firms across the various regulated sectors. However, statistical inferences, margins of error and confidence intervals cannot be applied to this data given our sample was not statistically selected.
- The conclusions in this report are based on the data available to the authors. All data is based upon the responses provided by firms.
- The JFSC cannot, and does not, accept any liability for reliance by any person on this report or any of the information, opinions or conclusions herein.