COMPLIANCE
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PI INSURANCE

Introduction: What is PI Insurance?

PI Insurance is a topic most businesses don't pay very much attention to. Typically, you will have an understanding of whether you have obtained it or not and if so, for roughly how much. Compliance Refinery sat down with Clinton Stanger and Michael Robertson for 90+ minutes (yes that's right, 90+ minutes on PI) and discussed; what PI insurance is and covers, how it should be incorporated into FAP governance and some key features not commonly known. We established 4 key tips for all FAP's and financial advisers;

1. *Read your policy:* Know and understand the wording, manage the risks and understand the areas not covered by your PI.
2. *Notify, notify, notify:* Call your PI provider early in the complaints process.
3. *Keep good records:* Client file notes are often the difference between a short defense and a long, stressful expensive one.
4. *Review your business structure:* Assess your business structure and who needs PI cover. If you have a complex model, engage your PI provider now. A complex structure would include a structure where an Adviser is in two different FAP's.

FAP licensing doesn't only incorporate regulatory requirements. Other variables can impact potential business structures and PI cover is definitely one of those.

How will the new regime consider PI?

FAP covers are starting to be discussed and a lot of covers won't be in place until the new regime takes place. PI providers haven't fully digested the new regime and still have to adapt. Naturally, the policies and wordings in relation will be required to adapt also. Class A FAP's are simple and will remain similar to the current regime. However, it gets more complicated with Class B and C licenses and Authorised bodies. A FAP will certainly require cover.

The idea that an adviser has separate cover which they control is very important. Generally, the owner of the policy is the person being defended. If it is the FAP only, advisers may feel without

representation or be a scapegoat by a FAP trying to protect the brand. We have seen evidence of this in the past with various product providers. Structurally it is incredibly difficult to fully understand and visualise what this may look like. The first indication of this may be in the agreements between the FAP and the Authorised Body or the Financial Adviser Consequently, advisers should have their own cover including other covers such as, Directors & Officers in respect of their own entities, also exposures such as statutory liability and general liability.

Advisers being in 2 FAPS:

Engage your PI Insurer early, these are considered complex and likely require individual cover. The more complex your business model, the more complex and expensive your insurance structure. Each FAP will likely get pulled into complaints and claims. As Michael Robertson explained "*The more stools you have, the more likely you are to fall between them*".

Complex busines structures – Engage your PI provider now!

Ensure all your entities are named on the policy, if you have a complex structure ask yourself why. The more complex your business structures are, the higher chance errors will occur (e.g., using the wrong brand). A complex business structure needs to engage now or you will risk the potential of not receiving cover, if left too late (and not meeting a FAP standard condition). As Clinton Stanger noted*, 't will take time to get some policies in place, you can't engage on 13th March and think you will get cover in place for more complex business models.*

What does PI Cover?

PI covers claims for third party financial compensation resulting from a breach of professional duty. A PI policy reasonably covers costs and expenses associated with defending the Insured. The Insurer has the right to conduct the defense of the Insured, which more often than not they exercise by way of appointing legal representation from their panel. This defends the adviser against claims and meets liability.

Fundamentally it is a defense cost policy, to which Defense costs can be exorbitant. A PI provider will step in to take over the conduct of the claim and will usually appoint an expert to defend you. It is in their best interest to get it resolved as quickly and cost effectively as possible. Most scenarios rarely go to court, often they go to a mediation and settlement.

It is important to remember that you still have to defend meritless claims, these can be expensive. Having good insurance is vital, and PI covers these and would defend all claims in the same manner.

How much of insurance should you have?

There is no hard and fast rule, however a catastrophic loss could end your business. Claims can linger for a long time, often challenging businesses reputation. Professionals often don't have

enough insurance and it creates significant issues when it happens. Most people don't think they will see a claim over $1,000,000. Businesses have to ask themselves; what happens if you don't meet the levels of cover?

- Typically limits of indemnity in the financial advice industry start at $1m Any One Claim, higher limits can be selected such as $2m, $5m, and $10m.
- Policies can have additional reinstatements, ie $1m Any One Claim and $2m in the Aggregate (ie one reinstatement of the policy).
- Policy limits can also be costs inclusive (ie defense costs are included in the limit) or Costs in excess of the policy limit.
- Generally financial advisers and FAP's have lower amounts of cover and premiums than other industries, we can expect these to increase over time.

How to choose an excess:

This is very simple. Choose an excess you can pay, not that keeps your premiums where you want them. Key considerations here are whether or not you have working capital in your business, or you have capital you can rely on to pay an excess.

What is the difference between being in a group scheme or an individual plan?

Insurance can sometimes be about scale. Being part of a group scheme can afford individuals better policy conditions, better premiums, and the comfort of being part of a larger group to avoid adverse underwriting decisions. However, specialization may bring about individuals who "don't fit a box" and therefore need an individual solution.

Group Schemes may be more efficient as they seek to buy a group limit of cover across many, rather than buying a high limit for an individual adviser business. Group policies will have Aggregate Limits for all claims under the scheme. An adviser should make sure they are comfortable with the shared approach. This can present risks in some cases as well. Individual schemes are harder to come by than group schemes.

How do different product lines impact cover amounts?

The type of advice has a large influence on the premiums and cover. Financial advisers' advice is split; however, Risk, Mortgage and Investment advice are relatively aligned. General insurance and the proportion of such advice influences cover and terms, noting this can further be split to domestic insurance or commercial insurance. The rationale for using type of advice to set premium levels, is based on the past claim's outcomes / potential risk for each facet of advice.

Should support staff be covered?

There have been instances where support staff and other personnel in the business have been included in potential complaints that require defending. They will incur expenses even if the claim has no merit. Make sure the Insured under the policy covers all those people involved in dealing with a client, from initial lead gathering, fact find, advice etc.

How to Manage Complaints or Claims

When to notify PI Provider:

Notify, Notify, Notify! PI insurance is there to help you. PI providers are professionals at responding to complaints and defending claims. At times advisers can hurt themselves or unnecessarily inflame the situation by responding independently. Notifying earlier means you will likely close off the claim earlier and with lower expenses.

Don't admit liability:

It becomes very hard to successfully settle a claim if an adviser has admitted liability. This can happen at times due to human nature and a desire to avoid conflict. Insurance will only pay on merit.

Meritless Claims:

You have to defend claims, even if they have no merit. They still have a cost to them. However, usually the most outrageous claim will have some truth. Advisers should try to learn from claims, even if they have no merit.

During a Claim:

Tell your insurer if you can't pay your excess. They can help make arrangements.

Be careful providing advice to Family Members and related entities:

Related entities can be an exclusion under a PI wording. The individual wording should be explored to ensure how wide these related entity definitions are. They can include trusts, other businesses owners etc… Read your policy and ask your broker to get a better understanding.

Dealing with people overseas isn't always covered:

Policy territory is important in these situations. Stock standard policies may be NZ only territory, meaning the policy only covers advice given to clients in NZ. Clients residing overseas, or emigrating overseas may not be covered by the policy unless the territory is extended. Ask your broker and read your policy. This is particularly important for bigger businesses with lots of clients.

An Overview of the NZ Professional Indemnity Insurance Market

The market is made up primarily of NZ based insurers; NZI Liability, Vero Liability, Chubb, AIG, Zurich, QBE, Berkshire Hathaway and then MGA's (managing general agents) who write business through overseas placements. This is compiled with the likes of Lloyds or other overseas based insurers; Delta, DUAL or ANDO.

The market for financial advisers is very limited due to the appetite of insurers. The NZ Market is primarily NZI Liability (who acquired Lumley 6 years ago) and DUAL, with other insurers participating on very selective individual accounts. Product Providers Risk Appetite is limited due to insurers / reinsurers poor experience in overseas markets. Lloyds markets are seeing large exposure to COVID related losses, and capacity to the market is becoming more restricted. A number of Lloyds syndicates have withdrawn from the PI market.

Insurers and furthermore reinsurers (effectively insurers own insurers, who provide treaty reinsurance) look to industry sectors to reduce capacity, or look for large premium increases with more restrictive terms. Such industries are financial institutions, financial advisers and other industries with occupations exposed to volatile such as valuers and engineers etc.

In summary, it will only get more expensive and insurers are not eager to be in this space.

Important considerations:

- Tell your business what actions should be taken. Anything outside the 'norm', you may not have cover for.
- Read your policy wording!

Negligence VS Civil wording

Negligent has to be an error or omission to trigger the cover.

Civil: Civil is there to cover and demand for compensation, or place demand on the professional, that their advice put the third party in a position that created a financial loss.

Group schemes vs individual cover: Group schemes can at times provide better cover over individual schemes. More complicated or specialized schemes.

If you have any questions, feel free to contact Compliance Refinery to discuss.

Reference: Compliance Refinery. (2020, October 5). Burgess, S., Stanger, C., & Robertson, M. (2020, October). PI insurance webinar [Video]. Vimeo. https://vimeo.com/469182579