

**INTERIM PRUDENTIAL SOURCEBOOK FOR INVESTMENT BUSINESSES
(PROFESSIONAL INDEMNITY INSURANCE FOR PERSONAL INVESTMENT
FIRMS) INSTRUMENT 2004**

Powers exercised

- A. The Financial Services Authority makes this instrument in the exercise of the following powers and related provisions in the Financial Services and Markets Act 2000 (the "Act"):
- (1) section 138 (General rule-making power);
 - (2) section 149 (Evidential provisions);
 - (3) section 156 (General supplementary powers); and
 - (4) section 157(1) (Guidance).
- B. The rule-making powers listed above are specified for the purpose of section 153(2) of the Act (Rule-making instruments).

Commencement

- C. This instrument comes into force on 1 February 2004.

Amendments to the Interim Prudential sourcebook for investment businesses

- D. IPRU(INV) is amended in accordance with the Annex to this instrument.

Citation

- E. This instrument may be cited as the Interim Prudential Sourcebook for Investment Businesses (Professional Indemnity Insurance for Personal Investment Firms) Instrument 2004.

By Order of the Board
15 January 2004

Annex

Amendments to IPRU(INV)

In this Annex, underlining indicates new text and striking through indicates deleted text. Where an entire new section of text is inserted, the place where it goes is indicated but it is not underlined. Where an entire section of text is deleted, the provisions to be deleted are indicated, but the text is not reproduced.

Delete IPRU(INV) 13.1.3 to IPRU(INV) 13.1.5.

After IPRU(INV) 13.1.2, insert the following new provisions as IPRU(INV) 13.1.3 to IPRU(INV) 13.1.5.

REQUIREMENT TO HOLD PROFESSIONAL INDEMNITY INSURANCE

- 13.1.3(1) G Under *Principles* 3 and 4 a *firm* is required to take reasonable care to organise and control its affairs responsibly and effectively with adequate risk management systems and to maintain adequate financial resources. Under *Principle* 9 a *firm* is obliged to take reasonable care to ensure the suitability of its *advice on investments* and discretionary decisions for any *customer* who is entitled to rely upon its judgement.
- 13.1.3(2) G Although financial resources and appropriate systems and controls can generally mitigate operational risk, professional indemnity insurance has a role in mitigating the risks a *firm* faces in its day to day operations, including those arising from not meeting the legally required standard of care when *advising on investments*. The purpose of 13.1.4(1) to 13.1.4(15) is to ensure that a *firm* has in place the type, and level, of professional indemnity insurance necessary to mitigate these risks. This includes, in the case of a *UK firm* exercising an *EEA right*, cover for breaches of obligations imposed by or under laws, or provisions having the force of law, in each *EEA State* in which the *firm* carries on business.
- 13.1.3(3) R The term "relevant income" in IPRU(INV) 13.1 refers to all income received or receivable which is commission, brokerage, fees or other related income, whether arising from the *firm's permitted activities* or not, for the last accounting year prior to inception or renewal of the professional indemnity insurance policy ("the policy").
- 13.1.4(1) R A *firm* must take out and maintain at all times professional indemnity insurance that is at least equal to the requirements of 13.1.4(2) to 13.1.4(15).

POLICY TERMS

- 13.1.4(2) R The policy must incorporate terms which are appropriate and must make provision for:

- (a) cover in respect of any claim for loss or damage, for which the *firm* may be liable as a result of an act or omission by:
 - (i) the *firm*; or
 - (ii) any *person* acting on behalf of the *firm* including *employees*, *appointed representatives* or its other agents;

LIMITS OF INDEMNITY – IMD INSURANCE INTERMEDIARY

- (b) appropriate minimum *limits of indemnity* per year, which are, if the *firm* is an *IMD insurance intermediary*, no lower than:
 - (i) €1,000,000 for a single claim against the *firm*; and
 - (ii) €1,500,000 in the aggregate;

LIMITS OF INDEMNITY – NON-IMD INSURANCE INTERMEDIARY

- (c) if the *firm* is not an *IMD insurance intermediary*, then the following *limits of indemnity* apply:
 - (i) if the *firm* has relevant income of up to £3,000,000, no lower than £500,000 for a single claim against the *firm* and £500,000 in the aggregate; or
 - (ii) if the *firm* has relevant income of more than £3,000,000, no lower than £650,000 for a single claim against the *firm* and £1,000,000 in the aggregate.

- 13.1.4(3) R If a policy is denominated in any currency other than euros, an *IMD insurance intermediary* must take reasonable steps to ensure that the *limits of indemnity* are, when the policy is effected (i.e. agreed) and at renewal, at least equivalent to those required in 13.1.4(2)(b).

READILY REALISABLE OWN FUNDS

- 13.1.4(4) G For the purposes of the following provisions relating to professional indemnity insurance, the *FSA* expects items included in *own funds* to be regarded as "readily realisable" only if they can be realised, at any given time, within 90 days.

ADDITIONAL REQUIREMENTS

- 13.1.4(5) E (a) In addition to the specific requirements in 13.1.4(2), to incorporate appropriate terms, the policy should make provision for the following:
- (i) for a *firm* with relevant income of more than £6,000,000, the aggregate limit identified in the table below:

Relevant income is (£)		Minimum aggregate <i>limit of indemnity</i> (£)
more than	up to	
6,000,000	7,000,000	1,150,000
7,000,000	8,000,000	1,300,000
8,000,000	9,000,000	1,450,000
9,000,000	10,000,000	1,600,000
10,000,000	12,500,000	2,000,000
12,500,000	15,000,000	2,400,000
15,000,000	17,500,000	2,800,000
17,500,000	20,000,000	3,150,000
20,000,000	25,000,000	3,800,000
25,000,000	30,000,000	4,250,000
30,000,000	35,000,000	4,500,000
35,000,000	40,000,000	4,750,000
40,000,000	50,000,000	5,500,000
50,000,000	60,000,000	6,000,000
60,000,000	70,000,000	6,750,000
70,000,000	80,000,000	7,250,000
80,000,000	90,000,000	7,750,000
90,000,000	100,000,000	8,500,000
100,000,000	150,000,000	11,250,000
150,000,000	200,000,000	14,000,000
200,000,000	250,000,000	17,000,000
250,000,000	300,000,000	19,750,000
300,000,000	n/a	22,500,000

- (ii) full retroactive cover in respect of the kinds of liabilities described in 13.1.4(2) for claims arising from work carried out by the *firm*, or on its behalf, in the past; and
- (iii) cover in respect of *Ombudsman* awards made against the *firm*.

- (b) Compliance with (a) may be relied on as tending to establish compliance with the requirement in 13.1.4(2) for the *professional indemnity insurance* terms to be appropriate.
- (c) Contravention of (a) may be relied on as tending to establish contravention of the requirement in 13.1.4(2) for the professional indemnity insurance terms to be appropriate.

13.1.4(6) G A *firm* should consider whether the overall cover is adequate taking account of 13.1.4(9)(b) and whether the *firm* should seek additional cover or legal expenses insurance. (Legal defence costs are costs of defence against claims that fall under the terms of the policy.)

- 13.1.4(7) G The cover provided by the policy should be wide enough to include the liability of the *firm*, its *appointed representatives*, *employees* and its agents for breaches of the *firm's* duty of skill and care, fiduciary duty, duty to look after documents or assets, fraud, and breaches of obligations imposed by or under *the Act* (or the Financial Services Act 1986 if relevant). If the *firm* operates outside the *UK* then the policy should cover other regulatory requirements imposed under the laws of other countries in which the *firm* operates.

EXCLUSIONS

- 13.1.4(8) R The policy must not be subject to conditions or exclusions which unreasonably limit the cover provided for in 13.1.4(2) (whether by exclusion of cover, by policy excesses or otherwise).
- 13.1.4(9) G (a) The *FSA* considers it reasonable for a *firm's* policy to exclude cover for:
- (i) specific business lines if that type of business has not been carried out by the *firm* in the past and will not be carried out by the *firm* during the life of the policy; or
 - (ii) specific claims that have been previously notified to the *firm's insurer* and claimed for under another policy.
- (b) The *FSA* does not consider it reasonable for a *firm's* policy to treat legal defence costs cover as part of the *limits of indemnity* if this reduces the cover available for any individual substantive claim.
- 13.1.4(10) E (a) The policy should not:
- (i) make provision for payment by the *firm* of an excess on any claim of more than £5,000. (This does not apply to the extent that the *firm* holds additional *own funds* in a readily realisable form, in accordance with 13.1.4(12)); or
 - (ii) exclude any type of business or activity that has been carried out by the *firm* in the past or will be carried out by the *firm* during the time for which the policy is in force. (This does not apply to the extent that the *firm* holds, by way of additional *own funds* in a readily realisable form, an amount equivalent to a reasonable provision against its potential liabilities for that business or activity. Guidance on this is given in 13.1.4(13) and (14)); or
 - (iii) exclude liability which is identified or crystallised as a result of regulatory action against the *firm* (either individually or as a member of a class of *authorised person*).
- (b) Contravention of (a) may be relied on as tending to establish contravention of 13.1.4(8).

EXCESS LEVEL

- 13.1.4(11) E The reference to "excess" in 13.1.4(10)(a)(i) is to the highest excess level required to be paid under the policy unless that excess relates to a type of business that has not been carried out by the *firm* in the past. In those circumstances, the reference is to the next highest excess level required by the policy.

ADDITIONAL OWN FUNDS

- 13.1.4(12) E The amount of additional *own funds* in 13.1.4(10)(a)(i) should be calculated by referring to the *firm's* relevant income and excess obtained in the following table:

All amounts are shown in £000s													
Relevant income is		Excess obtained, up to and including											
more than	up to	5	10	15	20	25	30	40	50	75	100	150	200+
0	100	0	4	7	9	12	14	18	21	28	34	45	54
100	200	0	7	11	14	17	20	25	29	38	46	59	70
200	300	0	9	14	18	21	24	30	35	45	54	69	82
300	400	0	11	16	21	24	28	34	39	50	60	77	91
400	500	0	13	18	23	27	30	37	43	55	66	83	98
500	600	0	14	20	25	29	33	40	46	59	70	89	105
600	700	0	16	22	27	31	35	42	49	63	74	94	111
700	800	0	17	23	28	33	37	45	52	66	78	99	117
800	900	0	18	24	30	35	39	47	54	69	82	103	122
900	1,000	0	19	26	31	36	41	49	56	72	85	107	126
1,000	1,500	0	23	31	37	43	48	57	66	83	99	124	146
1,500	2,000	0	26	35	42	48	54	64	73	93	109	138	161
2,000	2,500	0	29	38	46	53	59	71	81	102	121	152	179
2,500	3,000	0	32	42	51	58	65	78	89	112	132	166	195
3,000	3,500	0	35	46	55	63	71	84	96	121	142	179	210
3,500	4,000	0	38	50	59	68	76	90	102	129	152	191	223
4,000	4,500	0	41	53	63	72	80	95	108	137	161	202	236
4,500	5,000	0	43	56	67	76	85	100	114	144	169	212	248
5,000	6,000	0	48	62	73	84	93	110	125	157	185	231	271
6,000	7,000	0	52	67	79	90	101	119	135	169	199	249	291
7,000	8,000	0	56	72	85	97	107	127	144	181	212	265	310
8,000	9,000	0	59	76	90	103	114	134	152	191	224	280	328
9,000	10,000	0	63	80	95	108	120	141	160	201	236	294	344
10,000	100,000	0	63y	80y	95y	108y	120y	141y	160y	201y	236y	294y	344y
100,000	n/a	0	630	800	950	1080	1200	1410	1600	2010	2360	2940	3440
For <i>firms</i> with relevant income more than £10m but up to £100m value y is calculated by relevant income/ £10m													

EXCLUSIONS

- 13.1.4(13) G A *firm* should take into account the following when assessing the amount of additional *own funds* to be held as provision as described in 13.1.4(10)(a)(ii):
- (a) the type of business line or activity excluded and the types of claim which might arise from it;
 - (b) the number of contracts written or volume of activity;
 - (c) the number of complaints received by the *firm* relating to the excluded business or activity;
 - (d) generally accepted accounting principles applicable to provisions; and
 - (e) any other relevant information.
- 13.1.4(14) G If the *firm* holds additional *own funds* in accordance with 13.1.4(13) then the amount should be reviewed regularly. The reviews should take account of changes in the status of the policy exclusion(s) and any relevant changes to the *firm's* circumstances.

POLICIES PROVIDING COVER FOR MORE THAN ONE FIRM

- 13.1.4(15) R If the policy provides cover to more than one *firm* then in relation to 13.1.4(2) and (3):
- (a) the relevant income for calculating the *limits of indemnity* is that of all the *firms* named in the policy combined;
 - (b) each *firm* named in the policy must have the benefit of the minimum *limits of indemnity* as required in 13.1.4(2);
 - (c) each *firm* named in the policy must notify the *FSA* if the aggregate cover in the policy falls below the minimum in 13.1.4(2).

EXEMPTION FROM HOLDING PROFESSIONAL INDEMNITY INSURANCE

- 13.1.5 R A *firm* is not required to effect or maintain professional indemnity insurance if:
- (a) it is a member of the same *group* as a *bank, building society, insurer or friendly society*; and
 - (b) there exists between the *firm* and an entity specified in (a) above an enforceable, written agreement to provide equivalent cover to that required for professional indemnity insurance in 13.1.4(2).

- 13.1.6 GR (1) ~~*Firms may insure with any insurer which is authorised to transact professional indemnity insurance in the United Kingdom;*~~
A firm must take out professional indemnity insurance from:
- (a) *any insurance undertaking which is authorised to transact professional indemnity insurance in the EEA; or*
 - (b) *a person of equivalent status in:*
 - (i) *a Zone A country;*
 - (ii) *the Channel Islands, Gibraltar, Bermuda or the Isle of Man.*
- (2) ~~*Firms should seek advice from their broker on renewal of their professional indemnity insurance cover and to check that their broker is in possession of appendix 13(2)E and the requirements of 13.1.6E.*~~

...

13.1.9 R ...

Table 13.1(1)

This table forms part of 13.1.9

NOTIFIABLE EVENTS	
1.	<i>professional indemnity insurance cover, required in accordance with rule 13.1.3, being refused or cancelled;</i> In relation to professional indemnity insurance, required in accordance with 13.1.4(1) to 13.1.4(15) and 13.1.5, if: <ul style="list-style-type: none"> (a) it cannot be obtained within 28 days of the inception or renewal date; (b) it is cancelled; (c) the amount of aggregate cover is exhausted; (d) the <i>firm</i> commences business lines for which it had not obtained cover; (e) the <i>firm</i> is relying on 13.1.4(15); or (f) the <i>firm</i> is relying on 13.1.5.
2.	...

Delete all of Appendix 13(2)E 'Professional Indemnity Insurance Provisions'.