



Proposed amendments to ICAEW's Minimum approved wording - 2021

Application for an exemption direction concerning proposed amendments to ICAEW's minimum approved wording for accredited probate firms.

EXECUTIVE SUMMARY

1. This is a formal application to the Legal Services Board (LSB) for an exemption direction in accordance with paragraph 19 of Schedule 4 of the Legal Services Act 2007 (the Act) concerning amendments that are proposed to ICAEW's minimum approved wording from **1 September 2021**.
2. ICAEW's Probate Regulation requires that ICAEW accredited probate firms comply with the PII Regulations and hold a minimum limit of indemnity of £500k per claim in relation to authorised work (i.e. probate and estate administration activities). The minimum indemnity requirements of accredited probate firms are set out in **Probate Regulation 2.10** and **PII Regulation 3.5**.
3. The PII Regulations require that accredited firms hold 'qualifying insurance' with an ICAEW participating insurer. 'Qualifying insurance' is defined as insurance which is written in terms of the ICAEW minimum approved wording and which provides 6 years' retroactive cover. The PII Regulations also specify the minimum levels of cover firms must hold; the eligibility requirements of participating insurers; the constitution and responsibilities of the PII Committee and the Joint Advisory Pool, and arrangements for the Assigned Risks Pool (ARP)¹. Firms that enter the ARP receive cover in accordance with ICAEW's minimum PII requirements set down in the PII Regulations and minimum approved wording.
4. ICAEW is proposing to make some amendments to the minimum approved wording this year which are summarised below and set out in draft in **appendix 1**. The amendments are intended to take effect from **1 September 2021** to coincide with the renewal of ICAEW's agreements with participating insurers.

GOVERNANCE

5. The proposed amendments to the minimum approved wording have been approved by ICAEW's PII Committee and ICAEW Regulatory Board (IRB). Following internal governance changes that were made in 2020 in response to the LSB's internal governance rules for

¹ The ARP provides cover for up to 2 years for firms which are unable otherwise to obtain compliant cover in the commercial market.

approved regulators, the IRB is the relevant governance body within ICAEW for legal services matters.

6. The amendments have also been approved by the boards of Chartered Accountants Ireland (CAI) and the Institute of Chartered Accountants of Scotland (ICAS) as the PII arrangements for members and firms, including the minimum approved wording, are shared across the 3 institutes.
7. The proposed changes have also been the subject of public consultation which ran between 12 April and 21 May 2021. In addition, ICAEW consulted directly with 7 of the leading insurers during March to obtain their informal feedback on the proposed changes to the minimum approved wording. These insurers account for roughly half the capacity underwriting the institutes' assigned risks pool (ARP).

BACKGROUND

Clarifying 'Silent Cyber' risks

8. During recent years, so-called "silent cyber" has been an area of increasing focus for both regulators and insurers. The term reflects a concern amongst regulators that insurers may not fully understand the extent of their cyber exposures under different lines of insurance and so may not be pricing policies appropriately to manage risk.
9. Both the Prudential Regulation Authority (PRA) and Lloyds of London (Lloyds) have directed that clarity be brought to the market and that policies be clear on whether losses caused, or partially caused, by a cyber-related event or trigger are covered. The PRA said it expects all insurers to have action plans in place to reduce their silent cyber exposures and Lloyd's have mandated that all policies clarify the extent of cyber coverage under policies of insurance.²
10. In 2019/2020, the International Underwriting Association (IUA) undertook work to develop a model clause that could be applied by insurers to address the issue of "silent cyber". The IUA surveyed both PI and cyber insurers for their views on how risks should be allocated between the different policies, and then used this feedback to develop a model cyber clause (**appendix 2**). The IUA has said that the purpose of the clause is to ensure that traditional PI exposures remain covered, while claims more appropriately covered under a stand-alone cyber policy are excluded.
11. In response to these market developments, ICAEW's PII Committee developed amendments to the minimum wording to clarify the extent of cyber cover in policies of qualifying insurance held by ICAEW members and firms. The Committee used the IUA template clause as a basis for the amendments, but sought to tailor the wording and apply the exclusions to 'Relevant First Party Loss' only, which is defined as cover for defence costs incurred in investigating, reducing, avoiding or settling a potential Claim or circumstance (see paragraphs (c) and (d)

² Originally the deadline for compliance by PI insurers was 1 January 2021. However, earlier this year Lloyd's agreed a dispensation for insurers providing professional indemnity insurance to the regulated professions which extended the deadline for compliance until **1 October 2021**. The changes to ICAEW's minimum approved wording are proposed to take effect on **1 September 2021** in advance of this date.

of the definition of "Defence Costs" in the minimum approved wording). The intention in proposing the amendments is to ensure that the cyber endorsements that are being placed on PII policies by insurers do not conflict with the minimum approved wording, and that account is taken for the requirements that have been placed on insurers by their regulators, but that all existing cover for third party claims be preserved, even if a cyber-related event/trigger forms part of the cause/s of the losses claimed by the third party.

12. Preserving all existing cover for third party claims under the minimum approved wording was considered important for a number of reasons:

- a) Currently there are no regulatory requirements on ICAEW members or firms in public practice or those which engage in regulated activity (including probate) to hold separate cyber cover (although the PII Committee has sought to highlight the value of different types of insurances to ICAEW members / firms in recent years);
- b) Even where standalone cyber policies are held, it is understood that the terms of cover under these policies can be highly variable;
- c) Insurers have accepted that some of the third party claims cover excluded by the IUA model clause would not be covered under any typical cyber policy in any event, thereby resulting in firms retaining that risk uninsured;
- d) It is important for the ICAEW to be able to continue to hold out to the public the clarity of protection that exists when dealing with members in public practice of insurance protection for third party claims up to the required minimum level; attempting to explain what types of third party claims are and are not protected by the ICAEW's minimum insurance requirements would be complex and fundamentally lack clarity, which would serve to undermine the trust and confidence of the public when dealing with members

Proposed changes to the Minimum Approved Wording

13. Exclusions in relation to Relevant First Party Loss are proposed to be inserted at E20, E21 and E22 (see **appendix 1**). In addition, new definitions have also been inserted at B5 – B8 and B24, and a minor drafting amendment has been made in Section E ('*any Claim*' has been deleted from the stem wording and has been incorporated in all exclusions, save for E20 and E22).

LSB SIGNIFICANCE, IMPACT AND RISK (SIR) FRAMEWORK

ICAEW has considered the proposed 2021 amendments to the minimum wording in the context of the LSB's Significance, Impact and Risk (SIR) Framework. This response focuses on the significance, impact and risk of the changes to the wording in the context of accredited probate firms only, although the requirement to incept 'qualifying insurance' applies to all ICAEW members in practice and firms carrying on activity regulated under statute.

Significance

LSB Guidance:

By significance we mean how fundamental and big the change is. We will consider the following areas to help determine significance.

1. **Would the change require approval under the previous Ministry of Justice / Legal Service Consultative Panel system? This includes “changes relating to qualification regulations and rules of conduct relating to the rights of audience and rights to conduct litigation”. Potential impacts on rights of audience and fit with court rules has been a primary concern when considering any change in the past.**

ICAEW response - The proposed changes to the minimum wording do not relate to qualification requirements or conduct rules relating to rights of audience or the conduct of litigation. ICAEW accredited probate firms are not authorised to conduct these reserved legal activities.

2. **Is there a direct impact on or synergy with the Regulatory Objectives as detailed in Part 1 of the Act? All of the Regulatory Objectives are equally important but areas that we will particularly be considering when determining significance include:**

- a) **Impacts on competition in the provision of services, either increasing or restricting.**
- b) **Protecting and promoting the interests of consumers. As two of the areas highlighted as being of key concern to consumers we are likely to consider as being of particular significance:**
 - i. **alterations to how complaints are dealt with; and**
 - ii. **arrangements relating to financial protection including the handling of client money (account rules), indemnification and compensation.**
- c) **Encouraging an independent, strong, diverse and effective legal profession. Changes likely to impact on equalities and diversity will be of particular interest. Changes to core training and qualification and training requirements will also be deemed significant.**

ICAEW response – the proposed amendments are intended to have a positive impact on consumer protection. If the extent of cyber coverage under the minimum approved wording is not addressed, it is likely that insurers will look to add bespoke cyber endorsements on PI policies issued to ICAEW members and firms to comply with their regulatory requirements. Such endorsements are likely to be in line with the IUA model clause (**appendix 2**) which contains exclusions for third party claims which some insurers consider either:

- (a) to sit properly under a standalone cyber policy (e.g. theft of a client’s IP or money as a direct result of a cyber hack); or
- (b) to be uninsurable (e.g. systemic risks arising from a failure of a utility provider);

The amendments proposed by ICAEW to the minimum wording apply the IUA exclusions to Relevant Third Party Loss only, thereby preserving existing cover under the minimum approved wording for third party claims arising from a cyber event or which have a cyber-related trigger.

The introduction of these changes should allow insurers to continue participating in ICAEW's PII arrangements for members / firms, which is considered particularly important given the hardening nature of the PII market over the last ca. 18 months. Enabling ICAEW firms, including accredited probate firms, to access cover at a reasonable cost should benefit consumers as lower operational costs are likely to translate into lower fees for clients, and firms may only engage in public practice or carry on regulated activity (including regulated probate work) if they hold cover in accordance with the PII Regulations.

3. Is the change consistent with the Better Regulation Principles? Has consideration been given to the need to move to outcome and principle based regulation?

ICAEW response – The amendments are a response to a regulatory requirement on insurers to clarify the extent of cyber coverage under policies of insurance. The changes, which are based on the IUA model clause, have been tailored to allow insurers to comply with their own regulatory obligations while at the same time limiting the effect of the IUA exclusions and applying them to Relevant First Party Loss only. ICAEW consider this is a proportionate response to the request from insurers to address this issue.

ICAEW has been transparent in by communicating the proposed changes to insurers, ICAEW firms and members including accredited probate firms via a public consultation which was publicised on the ICAEW website, e-mail communications and other channels.

4. Will the change require a statutory instrument and / or parliamentary time in order to be completed?

ICAEW response – No.

5. Has there been activity in relation to changing the regulatory arrangement in the past two years for example an application made under the previous system, change considered by internal Board, consultation with regulated community or others? If so did the advice received, responses to consultation, or decision made raise any issues, either positive or otherwise indicate significance?

ICAEW response –

There have not been any changes to the minimum wording within the last two years; the current version of the wording took effect from 1 October 2018.

These proposed changes have been approved by ICAEW's PII Committee and the ICAEW Regulatory Board. During development, the amendments were discussed with the lead participating insurers and representatives of ICAS and ICAI as the PII arrangements are common across these institutes. ICAEW also consulted publicly on the changes between 12 April and 21 May, and the consultation was publicised through targeted communications to stakeholders including accredited probate firms, the Legal Services Consumer Panel, oversight regulators and participating insurers. A small number of responses were received (mainly from insurers) and a summary of these responses will be **available on our website shortly**.

Some insurers considered that the approach taken by the 3 institutes in applying the IUA model clause does not go far enough and that coverage for systemic risks should also be excluded. However, for the reasons set out above, the institutes have elected to maintain the policy approach of retaining all existing cover for third party claims under the minimum wording, and only a few changes of a minor / drafting nature were made to the amendments following the closure of the consultation in late May.

6. **How much interest in the alteration is there within the Justice system and therefore how much is the confidence of those with an interest in the Justice system likely to be impacted by the alteration?**

ICAEW response – N/A

Impact

LSB Guidance: By impact we mean what are the potential ramifications of pursuing a particular alteration? We will consider the following areas to help determine impact

7. **The number and proportion of people (consumers, procurers, regulated community) that will be affected by the alteration?**

ICAEW response - The PII Regulations and therefore the requirement to hold qualifying insurance apply to all ICAEW members in public practice and individuals and firms authorised by ICAEW to carry on activity regulated under statute, including accredited probate firms. The proposed changes do not affect the requirements of these firms to hold PII insurance or the level of cover required. The addition of the exclusions within the minimum wording will limit the cover that is available for Relevant First Party Loss, but do not affect the terms and scope of cover that is available for third party claims. This can be contrasted with the model clause proposed by the IUA (**appendix 2**) which may have the effect of restricting some third party claims, for example in relation to virus transmission.

8. **Is there an anticipated impact on the ability of members to practise, operate effectively, make a profit, and earn a livelihood?**

ICAEW response - No. The amendments do not affect the requirement to hold compliant PII for those individuals and firms within scope of the regulations. By reducing the breadth and application of any exclusion which may be applied by individual insurers unilaterally (which in some cases may seek wholesale exclusion of any cyber related losses) a minimum level of protection will be preserved for third party claims.

During discussions, some insurers have indicated that the approach taken by the institutes to 'silent cyber' could result in higher premiums, more questioning of insureds by insurers about their IT security measures and controls, or to some insurers refusing to provide cover. However, over the last 18 – 24 months there has been a significant hardening of the PII market generally, and the institutes are aware that cyber exposures are an increasing area of focus for insurers. It may, therefore, be difficult to distinguish the impact of these proposals from other general market / commercial factors.

9. **Will the change affect the ability of or requirements for prospective members to enter and/or operate effectively within the regulated community?**

ICAEW response – N/A

10. **Is there any crossover and / or conflict with other bodies regulating the same area or person? Are there differences in standards (standards must be comparable not necessarily the same)?**

ICAEW response – As the requirement on insurers to clarify the scope of cyber coverage in policies of insurance applies across the market, other approved regulators will need to

address coverage in their own minimum terms and conditions for PII policies held by regulated individuals and firms. ICAEW has engaged with the SRA, RICS and other approved regulators over this issue in recent months and understands that a common approach is being developed to limit the application of the IUA exclusions and preserve existing cover for third party claims.

11. The number of alterations included within the application.

ICAEW response – the amendments to wording are not extensive and include 3 additional exclusions and associated definitions. The changes are proposed to bring clarity to the scope of the minimum wording to assist insurers in meeting their regulatory obligations with the PRA and Lloyd's.

12. What are the integrated consumer protection and competition impacts? Will the proposed alteration result in the addition of regulation or the removal of regulation (as opposed to a neutral amendment to existing regulation)?

ICAEW response – we would characterise the proposed changes as a neutral amendment to existing regulation. There will be no change to the requirement on accredited probate firms and other members / firms to hold 'qualifying insurance' in accordance with the PII Regulations. Nor will there be any change to the scope of cover available under the minimum approved wording for third party cyber-related claims. The changes affect the scope of cover under the minimum approved wording for claims in connection with Relevant First Party Loss only.

We would highlight that the minimum approved wording specifies the minimum terms of cover to which all insurers subscribe. It is open to insureds to negotiate commercially extensions of cover beyond the minimum and it may be that firms seek additional cover (including via a stand alone cyber policy) for the aspects of cover that are excluded under the proposed amendments.

Risk

LSB: By risk we mean potential for having a detrimental impact on the regulatory arrangements. We will consider the following areas to help determine risk.

13. Previous track record of the AR in competently making changes that have been fully consulted on and the impacts fully assessed.

ICAEW response – Since the ICAEW began authorising and licensing firms for probate in 2014, the LSB has approved all but one application for an exemption direction in respect of an alteration to regulatory arrangements. ICAEW's application for approval of the 2019 amendments to the Disciplinary Bye-laws was approved in part only earlier this year.

Over the last year the LSB has stressed the benefits of consultation in the development of changes to regulatory arrangements. In response, ICAEW consulted publicly on the proposed changes to the minimum approved wording between April and May this year and a summary of the responses received to this consultation will be published on the ICAEW website shortly.

14. How transparent and robust are the internal processes that the AR will follow in making changes? In particular does the process incorporate appropriate consultation and use of impact assessments (please see paragraph 13)?

ICAEW response – As noted above, the proposed changes have been approved by ICAEW's PII Committee and the ICAEW Regulatory Board. The draft changes have been shared with participating insurers and ICAI and ICAS and feedback sought. ICAEW then conducted a public consultation which was published on ICAEW's website and consultees were further targeted through e-mail, social media and ICAEW's Regulatory and Conduct newsletter. These targeted e-mails included Practice Assurance principals, probate contact principals and contact principals in other regulated firms, oversight regulators, all participating insurers and the Legal Services Consumer Panel as well as the IUA. Feedback from the consultation responses was considered by the PII Committee and its Chair and resulted in some minor drafting changes to take account of the consultation responses.

15. Is there a high level of good quality data and evidence to support / justify the making the change? If not are there robust plans to obtain this information and for it to inform the change and enable actual impacts to be assessed.

ICAEW response - The draft changes to the minimum approved wording are a response to a requirement that has been placed on insurers by both the PRA and Lloyd's to clarify the extent of cyber coverage in policies of insurance. During March 2021, ICAEW held a number of meetings with leading insurers to understand that potential impact of these changes and the decision not to implement the IUA exclusions wholesale in the minimum approved wording (including in relation to third party claims). It was indicated at these meetings that the proposed approach may affect some insurers' appetite to underwriting certain risks and that insurers may require more information from insureds around their cyber security and controls at renewal. There was no indication that ICAEW's approach to the implementing the IUA's exclusions would result in fewer insurers seeking to participate in the arrangements from September 2021, but this is an area that will need to be kept under review.

16. How many would be impacted how quickly (immediacy of impact)?

ICAEW response – if approved by the LSB, the amended terms of the minimum wording will take effect in relation to accredited probate firms from 1 September 2021 to coincide with renewal of contract insurance arrangements with participating insurers. Given the nature of the proposed changes, accredited probate firms will not need to take any action to comply with the changes, although ICAEW will encourage firms to consider their exposures and insure accordingly. Although separate, standalone cyber cover is not currently a regulatory requirement for firms, ICAEW's PII Committee has sought in recent times to communicate the value of different insurances to firms and has emphasised the need for firms to consider their broader risk management strategy.

17. If the change did not go ahead, what would the impact be?

ICAEW response – If the amendments are not approved the minimum approved wording dated 1 October 2018 will continue to apply in relation to accredited probate firms which may mean that insurers seek to include their own exclusions or clauses in relation to cyber (which may restrict cover further for these firms) and may require dispensation from the PII Committee on an *ad hoc* basis. It is considered this may be confusing for firms, insurers and brokers and that it would be preferable if changes could be effective for all firms at the same time. Indeed, the revised wording will be effective in relation to other ICAEW members in practice and regulated individuals and firms from 1 September 2021.

18. How and when does the AR plan to assess the impact of the change following its introduction? What action would be taken if the benefits were not realised? Has consideration been given to whether there is need to include a defined sunset clause?

ICAEW response – N/A. As stated above, the changes proposed are a response to a regulatory requirement on insurers to clarify the scope of cyber coverage under policies of insurance. If the changes are not made, and the minimum wording is silent on this issue, it is anticipated that insurers will begin adding cyber endorsements to policies held by ICAEW members and firms which will conflict with the minimum approved wording.

ICAEW is mindful that the approach taken to implementing the IUA exclusions could impact on insurers' willingness to sign up to participate in the institutes' PII arrangements for members and firms from September 2021. The sign-up process for 2021/2022 is about to commence and the institutes will keep under review the number of insurers participating in the arrangements from September and the reason for any insurers electing to cease their participation.

Separately, the institutes will continue to liaise with the leading insurers on this issue and the market's approach to cyber risks through the Joint Advisory Panel, which meets twice per year (spring and autumn).

19. Has there been activity in relation to changing the regulatory arrangement in the past two years (see paragraph 5)? Has any other AR made a similar change or undertaken activity relating to a similar regulatory arrangement in the past and was there any detrimental outcome or did the change process identify the potential for a detrimental impact?

ICAEW response – No - There have not been any changes to the minimum wording within the last two years (amendments have not been made to the minimum approved wording since October 2018). As the requirement on insurers to clarify the extent of cyber-related cover under policies of insurance applies across the market, ICAEW is aware that the other approved regulators, including the SRA, are also considering changes to their minimum terms and conditions for PII in response.

20. If the change introduces regulation, does the AR have the capability of identifying breaches and providing / ensuring appropriate remedy and / or enforcement (see paragraph 12)?

ICAEW response – N/A. The nature of these changes do not introduce additional regulation for accredited probate firms. Such firms are required under both the Probate and PII Regulations to hold cover in accordance with the PII Regulations and minimum approved wording.

Appendices

1. Draft minimum approved wording - tracked changes
2. IUA model clause