

Cayman Islands Monetary Authority

PRIVATE SECTOR CONSULTATION



STATEMENT OF GUIDANCE – PROFESSIONAL INDEMNITY INSURANCE FOR TRUST, INSURANCE, MUTUAL FUND ADMINISTRATOR, SECURITIES INVESTMENT BUSINESS AND COMPANY MANAGEMENT LICENSEES AND DIRECTORS

A. Introduction

1. Section 34(1)(a) of the Monetary Authority Law (2013 Revision) (as amended) ("MAL") states that –

After private sector consultation and consultation with the Minister of Financial Services, the Authority may –

- (a) *issue or amend rules or statements of principle or guidance concerning the conduct of licensees and their officers and employees, and any other persons to whom and to the extent that the regulatory laws may apply;*
2. Requirements specific to the private sector consultation are outlined in section 4(1) of the MAL as follows:

When this Law requires private sector consultation in relation to a proposed measure –

- (a) the Authority shall give to each private sector association a draft of the proposed measure, together with –*
 - i. an explanation of the purpose of the proposed measure;*
 - ii. an explanation of the Authority's reasons for believing that the proposed measure is compatible with the Authority's functions and duties under section 6;*
 - iii. an explanation of the extent to which a corresponding measure has been adopted in a country or territory outside the Islands;*
 - iv. an estimate of any significant costs of the proposed measure, together with an analysis of the benefits that will arise if the proposed measure is adopted; and*
 - v. notice that representations about the proposed measure may be made to the Authority within a period specified in the notice (not being less than thirty days or such shorter period as may be permitted by subsection (3)); and*
- (b) before proceeding with the proposed measure, the Authority shall have regard to any representations made by the private sector associations, and shall give a written response, which shall be copied to all the private sector associations.*

3. The Cayman Islands Monetary Authority ("the Authority" or "CIMA") seeks consultation and comment from the private sector associations concerning the following:
 - a. Draft Statement of Guidance ("SOG") on Professional Indemnity Insurance ("PII").

B. Background

4. PII is used by many financial industry professionals and businesses across the world, including the Cayman Islands, and has become a staple risk mitigation tool. It provides protection to the professional individual and business as well as the clients they serve. Consequently, PII is a significant regulatory consideration worldwide and the Authority continues to seek facilitation of adequate regulation and supervision in this regard. Legal requirements for PII have been enacted for the trust, insurance, securities investments and company management sectors. Legislation on PII has also been extended to corporate and professional directors.
5. In March 2008 the regulatory framework for PII coverage was strengthened as the Authority issued a Statement of Guidance on Professional Insurance for Trust Companies. The measure was issued pursuant to sections 15(2) and 15(3) of the Banks and Trust Companies Law (2007 Revision), now reflected in sections 15(1) and 15(2) of the 2013 Revision. The SOG was issued to provide guidance to Trust Companies on their obligation to "maintain adequate professional indemnity insurance, or to have in place other appropriate arrangements to cover risks, in respect of its trust business ..."
6. At the time, this measure provided support to the earlier legal inclusion of PII requirements for trust companies (as an amendment of the Banks and Trust Companies (2003 Revision)). The issued guidance was a direct result of ongoing consideration to improve regulatory transparency in relation to PII coverage used by licensed trust companies. However, this issuance was absent of conscious recognition of its relevance and need for similar application to other licensees.
7. Consequent on the preceding, the Authority has sought to extend the current SOG on PII for Trust Companies to all relevant licensees while simultaneously broadening its scope. This will complement existing legislation/regulation, improve transparency and bolster the current framework in requiring, guiding and promoting adequate PII coverage within Cayman's financial system.

C. Jurisdictional Comparisons

8. Australia, Guernsey, Isle of Man, Jersey, Malta, Singapore, United Kingdom, though differing in some circumstances, all provide licensee guidance on PII. Bahamas, Barbados, Bermuda and Malaysia did not have any explicit guidance on PII but established requirements in law/regulation.

Australia

9. The Australian Securities & Investments Commission ("ASIC") is Australia's corporate, markets and financial services regulator. ASIC utilises regulatory guides to establish the expectation of its licensees as it relates to PII under the broad compensation and insurance framework. These guides include, for example, the Regulatory Guide 126 and 210 on Compensation and Insurance arrangements for Australian Financial Services ("AFS") and credit licensees

respectively. These documents outline, in part, expectations relating to adequacy of PII, alternative arrangements, exemptions and disclosures in licensees financial services guide issued to retail customers.

Example: Guidance on determination of PII Adequacy and Alternatives

PII Adequacy	Alternative Arrangements
<p>In part, the guidance outlines the need for PII which is adequate considering:</p> <ol style="list-style-type: none"> 1. Liability for claims brought through respective external dispute resolution (“EDR”) schemes. 2. The nature of financial services business carried on, including: <ol style="list-style-type: none"> a. The volume of business; b. The number and kind of clients; c. The kind or kinds of business; and d. The number of representatives. 3. Amount of cover – the limit of indemnity under the policy should cover a reasonable estimate of potential losses. 4. Scope of cover – Insurance must cover loss or damage suffered due to breaches of obligation by the licensee and its representatives. 5. Terms and Exclusions – Exclusions in PII policy should not undermine the policy objective. 6. Financial Resources – Consideration must be given to how policy excesses will be covered. Financial resources should be available to cover the excess and gaps in cover due to various exclusions. <p>The guidance also stipulates minimum expectations considering certain key policy features. These include, amount of cover, scope of cover, exclusions, persons covered, automatic reinstatements, excess/deductibles, legal costs, EDR scheme awards, fraud, approved product list, retroactive cover and ‘run-off’ cover.</p>	<ol style="list-style-type: none"> 1. Licensees will need to apply to the regulator for approval to use alternative arrangements. 2. Alternatives should be adequate in substance to meet the policy objective, hence having the same broad effect as PII. 3. For example the following arrangements may fall within the category of PII: <ol style="list-style-type: none"> a. Some types of trustee liability insurance held by superannuation trustees; b. Group insurance, where a small number of associated licensees are covered by one policy; and c. A PII policy provided under a group master scheme. 4. Details provided on how to apply for such approval and how applications will be assessed: <ol style="list-style-type: none"> a. Regulator will generally ask for an expert report (e.g. actuarial report) to assess whether arrangements give no less protection the PII. b. Considerations for assessing the adequacy of PII should also be applied to alternative arrangements.

Guernsey

10. The Guernsey Financial Services Commission issues Codes of Practice for the entities which it regulates. Embedded in these codes, where appropriate, are guidance notes. Guidance on PII is provided to relevant entities. For example, the Code of Practice for corporate service providers includes a guidance note for PII which forms a part of its requirements related to the entity maintaining adequate financial resources.

Example: Guidance on PII in Codes of Practice

<p>Code of Practice – Corporate Service Providers</p>	<ol style="list-style-type: none"> 1. <i>Need for licensee to be solvent and able to meet the risks they face, for example a well-founded claim by a client.</i> 2. <i>Each licensee responsible for assessing the level of resources (including insurance cover) which is necessary to enable it to meet its liabilities as they fall due and to withstand risks to which it is subject.</i> 3. <i>PII cover needs to include cover against negligence, errors or omissions by licensees and against any liability it might have for the dishonest acts of its employees.</i> 4. <i>Cover must extend to liabilities which the licensee might incur in any other jurisdiction in which it carries on business and to liabilities of its staff who, in the course of their duties, perform functions (for example acting as director) in their own names.</i>
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Jersey

11. The Jersey Financial Services Commission has issued a Guidance Note on Professional Indemnity Insurance. This guidance applies to persons registered to carry on investment business, trust company business, general insurance mediation and fund services business. PII requirements are established in the Codes of Practice for each of the business sectors stated. The issued guidance provides information on treating with PII policy limitations, retroactive date, policy excess and PII variances.

Example: Guidance on determination of PII Adequacy and Alternatives

PII Adequacy	Alternative Arrangements
<p>The guidance provides information on:</p> <ol style="list-style-type: none"> 1. PII Policy Limitation – The Commission does not require notification of exclusions and limitations that are typically 	<ol style="list-style-type: none"> 1. A registered person may request the Commission to vary requirements established by the Codes where strict adherence to the Codes would produce an anomalous result.

<p>included with standard market wordings. If there are exclusions or limitations that are specific to the licensee, these should be drawn to the Commission's attention, in line with the requirements of the Codes.</p> <p>2. Retroactive Date – Licensees are required to maintain adequate insurance cover at all times and PII policies operate on a “claims-made” basis. Any retroactive date may have the effect of leaving the registered person in breach of the Codes, and therefore may not be acceptable. Consequently, where there is a retroactive date in the PII policy, it must be notified to the Commission, together with an explanation as to why it has been applied by the insurer.</p> <p>3. Characteristics of an Excess – Where a PII policy is subject to an excess or deductible, and the Codes establish a minimum limit of indemnity, the Codes state that “any excess (or deductible) per claim on the policy should not reduce the limit of indemnity payable under the policy”</p>	<p>2. Requests for a variance of the PII requirements of any Codes should be made in writing to the Commission.</p> <p>3. Examples of areas where the Commission may consider granting variances from the PII requirements of the Codes include:</p> <p>a. <i>Where the Codes specify the maximum excess per claim which may be included on a PII policy:</i> Where a variance of this nature is granted the Commission generally requires additional funds to be held through adjustment to either the Adjusted Net Liquid Assets calculation or the solvency calculation, as applicable. The value of the additional funds to be held is generally three times the amount by which the PII policy excess exceeds the maximum permitted by the relevant codes.</p> <p>b. <i>Ability to self-insure:</i> Ordinarily PII cover will be purchased from an insurer; however, the commission will consider requests from registered persons wishing to enter into self-insurance arrangements. The written request submitted should be accompanied by details information as to how the registered person intends to structure and finance its self-insurance arrangements.</p>
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United Kingdom (“UK”)

12. The Financial Conduct Authority (“FCA”) regulates over 70,000 businesses including, but not limited to, financial advisers, investment managers and insurance intermediaries. The FCA works alongside the Prudential Regulation Authority (“PRA”) in regulating financial system entities. The FSA has issued a factsheet (No. 027) for regulated firms which require PII cover. The factsheet provides guidance on how to purchase PII but also provides important information relating to the rules for holding PII, the PII market and how to obtain PII. This particular research finding provided insight into possible solutions for firms facing challenges in obtaining PII, as is the case in the Cayman Islands.

Example: Factsheet Inclusions

<p>Factsheet No. 027 – For all firms that hold/need PII: Buying Professional Indemnity Insurance</p>	<ol style="list-style-type: none">1. <i>Critical issues for getting cover:</i><ol style="list-style-type: none">a. <i>Know who is being dealt with and who they represent.</i>b. <i>Check if broker deals directly with PII market, or through another broker and how much it will cost.</i>c. <i>Find out what service the broker is offering, for example will they provide advice.</i>d. <i>Find out which insurers can be assessed.</i>e. <i>Check if they are specialists or knowledgeable about licensee sector.</i>2. <i>Four main areas insurers look at when calculating premiums:</i><ol style="list-style-type: none">a. <i>Total income;</i>b. <i>Required limit of indemnity and level of excess;</i>c. <i>Risk profile of the business; and</i>d. <i>Nature of business.</i>3. <i>Critical Issues for licensees:</i><ol style="list-style-type: none">a. <i>Seek guidance on which areas are of particular concern to insurer; and</i>b. <i>Consider where it is possible to provide comfort to insurers, for examples types of services and proper record keeping.</i>
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D. Purpose of proposed Statement of Guidance

13. Evidenced through the expectations in international standards and vast jurisdictional regulatory application, PII adequacy is a significant area of concern for financial system safety and stability. It is with this acknowledgement that the Authority needs to comprehensively address PII adequacy in the regulatory framework of the Cayman Islands.
14. The purpose of the proposed measure is to provide clear guidance to all relevant licensees on the expectations of the Authority in regard to the material areas of PII coverage (and the application of appropriate alternatives where necessary).
15. The proposed SOG will also seek to provide some amount of regulatory coverage to Mutual Fund Administrators, which currently are not required by law to have PII cover. Adequate PII cover represents a significant matter of best practice.

16. Finally, the measure will provide a more inclusive and detailed basis upon which the Authority's supervisors can conduct assessments of licensees to determine the adequacy of PII coverage being utilised. This will significantly reduce the need for supervisory discretion and encourage more consistent application.

E. Proposed Inclusions in the Statement of Guidance

17. The proposed SOG will have comprehensive inclusion and now apply to the following licensees:
 - a. Trust Companies;
 - b. Insurance Brokers, Insurance Managers and Insurance Agents;
 - c. Mutual Fund Administrators;
 - d. Securities Investment Businesses;
 - e. Corporate Service Providers and Company Managers; and
 - f. Corporate and Professional Directors.
18. This will allow necessary communication of the Authority's expectations on PII to all relevant licensees. Notably, the Directors Registration and Licensing Law 2014 ("DRLL") is not a regulatory law as defined by the MAL. Statements of Guidance issued in accordance with the MAL apply only to regulatory laws. Additionally, Mutual Fund Administrators are not legally required to maintain PII under the Mutual Funds Law (2015 Revision) ("MFL").
19. Consequently, the proposed SOG does not have a legal basis for application to DRLL and MFL licensees but will serve as a reference guide until the MAL and MFL are revised.
20. One highlighted area of deficiency in the current SOG on PII for Trust Companies was the lack of clear guidance on what constituted adequate coverage. The proposed SOG will seek to improve upon this insufficiency by clearly stipulating the need for the presence of certain minimum policy features relating to:
 - a. Amount of Cover (Limit);
 - b. Excess/Deductibles;
 - c. Scope of Cover;
 - d. Exclusions;
 - e. Persons Covered;
 - f. Automatic Reinstatement;
 - g. Legal Costs;
 - h. Fraud/Dishonesty/Infidelity;
 - i. Retroactive Cover; and
 - j. Run-off Cover.

These features were outlined within the context of the need for comprehensive risk assessment employed by licensees in determining the adequacy of PII cover.

21. Consequently, the SOG outlines various important factors for general consideration when undertaking assessments to conclude on the suitability of PII coverage. In addition, considerations for establishing appropriate policy limits and excesses were specifically highlighted in the measure.
22. The SOG also outlines that licensees should maintain, where practicable, PII with domestically licensed insurers. This was done in order to assist in providing CIMA with more confident oversight of PII coverage while promoting the domestic insurance market.
23. Additionally, the measure provides guidance on assessing the financial strength of insurance providers. This is achieved by outlining additional independent rating

agencies which licensees may refer to when selecting a provider. The SOG also states an expected minimum rating benchmark, for potential insurers, of A.M. Best B+ or equivalent.

F. Estimation of significant costs and benefits

24. The table below shows the costs and benefits of the proposed SOG.

Table 1

	Costs	Benefits
CIMA	<ol style="list-style-type: none"> 1. Conduct consultation. 2. Gazette and publication of new measure. 3. Amend supervisory manuals. 4. Training of Division's staff. 	<ol style="list-style-type: none"> 1. Enhance and support regulatory processes, in particular the application process and on-site inspection. 2. Supports internal training for new staff in all divisions. 3. Ensures adequate inclusion of all relevant licensees with greater transparency of the Authority's expectations. 4. Incorporate and consolidate guidance on PII in one measure across sectors. 5. More effective adoption, by licensees, of adequate risk management mitigation tools decreases compliance and enforcement costs for CIMA.
Cayman Islands	None	<ol style="list-style-type: none"> 1. Raise the jurisdiction's profile as an international financial centre. 2. More transparency and protection for prospective and current clients of licensees. 3. Lessen the risks, and potential losses, attached to not having adequate PII from financially sound issuers. 4. Improve results of future assessments by international standard setters.
Licensees	<ol style="list-style-type: none"> 1. Enhancement or implementation of appropriate policies and procedures with respect to assessing adequacy on PII coverage (risk based assessments). 2. Additional PII premiums (if current policy limits do not meet minimum requirements). 	<ol style="list-style-type: none"> 1. Increased consistency in the approach and business practice with regard to PII. 2. Reduces risks relating to possible civil liability. 3. Increase certainty for on-site inspections (which may include assessment of PII adequacy).

G. Comments and Consultation

25. The Authority seeks consultation through written comments and representations from the private sector associations concerning

- Draft SOG on Professional Indemnity Insurance for Trust, Insurance, Insurance, Mutual Fund Administrator, Securities Investment Business and Company Management Licensees and Directors.

26. The Authority must receive representations by 17H00, 18 March 2016.

27. Comments and representations must be addressed to

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[With copy to: P.McAllister@cimoney.com.ky](mailto:P.McAllister@cimoney.com.ky)

28. The Authority shall have due regard to any representation made by the private sector associations and industry stakeholders. The Authority shall provide a written response collating the feedback received and the Authority's position on this feedback. This response shall be copied to all relevant private sector associations only.