

REPORT TO: CILEx REGULATION BOARD

FOR: DECISION

DATE: 18 JULY 2017

REPORT TITLE: COMPENSATION ARRANGEMENTS AND GUIDANCE

SUBMITTED BY: Victoria Purtill, Director of Authorisation and Supervision

PURPOSE OF REPORT:

1. This paper seeks formal approval to make an application to the LSB to amend the compensation arrangements which protect consumers in the event that a CILEx authorised entity acts dishonestly and either misappropriates funds or fails to account.
2. The proposal removes the requirement for CILEx to provide a £1m fund to support compensation claims in the circumstances set out above and replaces that fund with largely insurance backed compensation arrangements.
3. The application will be reviewed for approval by the CILEx Council at its meeting on 13 July 2017.

BACKGROUND:

4. The client protection arrangements in operation at CILEx Regulation comprise:
 - Professional Indemnity Insurance (PII) of £2m to cover mistakes made by the entity
 - Compensation for clients, for loss in all or part caused by the entity either misappropriating funds or failing to account. This is currently covered through a £1m fund provided by CILEx and a £1m insurance policy
5. The CILEx Council at its May 2016 meeting reaffirmed its support for entity authorisation and ABS and agreed that CILEx Regulation should develop alternative client protection arrangements.
6. The proposed changes seek to amend the compensation arrangements for consumers in the event that an authorised entity misappropriates client funds or fails to account. The changes referred to in this paper do not amend the PII arrangements.
7. The proposed changes are designed to create a more practical, affordable and sustainable model of compensation arrangements to protect consumers.
8. The proposed changes can be summarised as follows:

- Replacement of the £1m fund provided by CILEx with an insurance policy which provides annual compensation in the event of a claim of £2m per authorised firm and an aggregate of £6m
 - Clarity in the eligibility requirements in relation to who will be eligible to make a claim for compensation under the revised arrangements
 - A general time limit of 1 year to make claims, with a right to make an exceptional circumstances claim outside that time limit
9. Supporting this paper are the following documents, which can be found on the [CRL Board](#) Sharepoint – go to Calendar/18 July 2017/CRL Board:
- Draft application to LSB for amendment of the compensation arrangements at CILEx Regulation (Annex 1)
 - Draft rules and explanatory table, mapping the amendments (Annex 2)
 - Consultation documents (Annex 3 and Annex 4)
 - Draft guidance (Annex 5)
 - Confidential Annex 6 (attached to this paper)
10. We have been liaising with the LSB in relation to the proposed amendments to the compensation arrangements and the draft application attached to these papers is currently with the LSB for comment. Therefore, it may be subject to further minor changes, but the substance of the application will remain as set out.

ISSUES FOR CONSIDERATION:

11. The proposed changes to the compensation arrangements in place at CILEx Regulation are being made for the following reasons:
- To make the compensation arrangements more **proportionate and cost-effective**, by replacing the £1m fund supplied by CILEx with an insurance policy which will provide cover of £2m per firm (with a maximum claim per client of £0.5m) and an annual aggregate of claims coverage of £6m. A fund will continue to operate, but this will be built up over time from contributions from CILEx authorised entities. These contributions are used in the first instance towards the payment of the insurance premium, but over time, as the number of regulated entities grows, this will create a surplus to build a fund as part of the arrangements.
 - To make the model of compensation available to consumers more **sustainable** by ensuring that this level of coverage is available annually to all clients who suffer loss and can meet the eligibility criteria, which would not be possible under the current compensation fund arrangements as the £1m fund is not able to be replenished should claims reach that limit.
 - To provide greater **clarity** in the rules in relation to eligibility criteria for making a claim on the compensation arrangements
12. We have consulted on the proposed changes and the consultation analysis is attached at Annexes 3 and 4.
13. As the existing guidance is considered a regulatory arrangement, we have

decided that at this stage that it will need to remain in place. We have updated it for the new arrangements and to allow for the Licensing application. We will then provide more simplified information for consumers on the website and review the claims material.

14. In summary, CILEx Regulation sought the views of consultees on the following proposed changes:

- Views on the proposed change to an insurance backed compensation scheme
- Views on the introduction of eligibility criteria into the compensation arrangements rules
- A proposal to fund unpaid run off cover where an entity defaults on its PII premium
- Introducing a £2m aggregate in respect of claims against 1 firm
- Any other comments

15. We received 18 responses to the consultation, including a response from CILEx. The responses were broadly supportive of the changes proposed.

16. As a result of the consultation responses, we have made minor amendments to the eligibility criteria, including the expansion of those able to submit a claim on the arrangements to include micro-businesses with assets/turnover not exceeding £2m. This is consistent with other compensation arrangements in the sector. It should be noted however, that in all cases, in order to be eligible, an applicant must be able to demonstrate hardship. In addition, we have also introduced a discretionary extension to the rule that claims should be brought within 1 year on the basis of responses received.

17. Also as a result of the consultation, we have decided not to proceed with the proposal to reserve the right to pay an unpaid PII run off premium where the entity defaults on that premium. The proposal was not supported by any consultees and having consulted with the Qualifying Insurers on the point, it became clear that we may not have an insurable interest, required to enable payment to be made.

RECOMMENDATION:

- The Board is asked to approve the submission to the LSB, of the application to amend the compensation arrangements.

IMPACT ASSESSMENT:

Public/Consumer	
Consumer	Maintains consumer protection and provides additional clarity on application

Public interest	Aligned with providing protection to the consumer
Environment	None
Regulated Community	
Cost of Regulation	No immediate direct impact on regulatory costs but helps maintain sustainability.
Equality and Diversity	No direct impact
Us	
Reputation/Brand	Maintains our position of providing appropriate consumer protection in line with other regulators. By taking a proportionate approach enables us to provide security for the future.
Resources:	Allows the group to free up resources of £1M.
Operations:	Time resource has previously been committed for the redrafting and consultation work by the Senior Team.
Risk:	Risk of insurer backing out of market
Finance:	Increase in insurance premium of c10%.
Legal:	No direct impact.
IT:	No direct impact

APPENDICES:

- Annex 1: Draft application to LSB for amendment of the compensation arrangements (available in Sharepoint)
- Annex 2: Draft rules and explanatory table, mapping the amendments (available in Sharepoint)
- Annex 3 and 4: Consultation documents (available in Sharepoint)
- Annex 5: Draft guidance (available in Sharepoint)
- Annex 6: Confidential Note (attached)