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REGULATORY

Diversity and inclusion in the financial sector – regulators consult on important changes

Both the Prudential Regulatory Authority (PRA) and the Financial Conduct Authority (FCA) have published recent consultations on diversity and inclusion (D&I) in the financial sector, including insurance, building on previous work in this area.

Both consultations close on 18 December 2023, with new rules expected to come into effect one year after publication of the final policy. The consultations address issues including: mandatory D&I targets; the need for board and firmwide D&I strategies and responsibility for setting and overseeing them; publication of D&I information; and the incorporation of non-financial misconduct within regulatory frameworks. We discuss the consultations further and the steps firms should be taking as a result, in our briefing here.

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PRA sets out its approach to mutual insurers

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"...mutual insurers need to be proactive in their relationships with the PRA and take a robust approach to their regulatory obligations."

Shoib Khan of the PRA recently spoke about the PRA's approach to mutual insurers at the Association of Financial Mutuals Annual Conference 2023. In his speech Khan set out some of the PRA's expectations of the sector and highlighted regulatory reforms that may have a positive impact on the regulatory burden faced by mutual insurers.

One of the main themes of Khan's speech was that of financial resilience. Whilst stating that the PRA considers the UK life and general insurance markets to be resilient, unsurprisingly he touched upon current economic challenges that are impacting corporates and mutuals alike, including inflation and high interest rates. Drawing from the PRA's Dear CEO letter published earlier in the year, Shoib reminded the AFM that firms need to be able to respond to market and credit risk conditions different to those from the past and that steps should be being taken to ensure that risk management frameworks, conceived in different economic conditions, continue to operate effectively. Referring to regulatory reforms that the PRA considers will be beneficial to the mutual insurance sector, Shoib focussed on reforms to the UK's Solvency II regime, highlighting that proposed increases to size thresholds and streamlined reporting requirements would have a positive impact on the regulatory burden faced by smaller mutual insurers. He stated that reforms being pursued by the PRA would further support the principal of proportionality, resulting in a less burdensome regulatory regime for mutual insurers (whilst boosting competition) and requested that mutual insurers give their input on the ongoing proportionality challenges faced by them.

Khan also set out the PRA's support for the AFM's current focus on collaboration between mutuals, stating that this could provide tangible benefits for members. He also indicated the PRA's readiness to join the collaborative efforts of mutuals, pointing out that PRA specialists had already been liaising with the AFM on common operational resilience issues faced by mutuals. However, this support was caveated by the expectation that the risks of collaboration between mutuals were considered carefully and that the PRA would be engaged where plans for collaboration could impact the PRA's objectives.

Overall, whilst Khan's speech was one of positivity and collaboration, with a commitment to proportionality in respect of the regulatory regime, the underlying message was that, particularly in light of tough economic conditions, mutual insurers need to be proactive in their relationships with the PRA and take a robust approach to their regulatory obligations.

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> **"In terms of the Court of Appeal, the insurer's main argument on appeal was Tughans was not entitled to the success fee and, therefore, its repayment to the payor was not a loss under the insuring clause."**

DISPUTES

Professional Indemnity insurers liable for insured's professional fee

The Court of Appeal made clear that the question of cover for a claim for return of fees by an insured firm is more nuanced than previously thought

In *RSA v Tughans* (2023), the UK's Court of Appeal recently considered whether a solicitor firm's professional indemnity policy covered claims for damages made against the firm and/or its partners in respect of fees paid to the firm.

The Court of Appeal decided, in the circumstances of the case, those fees were recoverable from insurers.

It is the first case in England and Wales to have looked at this important issue.

This matter concerned a success fee of £7.5m ($9.2m) paid to Northern Irish law firm Tughans on completion of the sale of a book of property loans by a bank established by the government.

A partner at Tughans (C) was engaged by another law firm, Brown Rudnick LLP. Unbeknown to the other partners, C made certain representations and warranties about how the success fee would be used, including that no part of it would be paid to a government official.

After paying the fee, Brown Rudnick alleged the engagement had been breached and/or the representations made by Tughans were fraudulent. Brown Rudnick claimed damages from Tughans for the alleged breaches and/or misrepresentations. The claimed damages included the success fee.

Tughans sought cover from its professional indemnity insurer in respect of Brown Rudnick's claim. The insurer denied cover and Tughans commenced arbitration. For the arbitration and subsequent appeals, it was accepted innocent Tughans partners could claim on their own behalf, notwithstanding the allegations of fraud against C.

The insurer denied cover on the basis the insuring clause was written "in respect of any civil liability... incurred in connection with the practice carried on by or on behalf of the solicitor" and such civil liability cover did not include the success fee. The insurer also argued Tughans did not suffer loss in relation to the success fee because it was procured by a mis¬representation and had therefore never been earned by Tughans.

The arbitrator found the work carried out by Tughans was "solicitorial" and it was contractually entitled to the success fee. Accordingly, the claim for fees as damages fell within the insuring clause. The Commercial Court upheld the arbitrator's decision on appeal.

In terms of the Court of Appeal, the insurer's main argument on appeal was Tughans was not entitled to the success fee and, therefore, its repayment to the payor was not a loss under the insuring clause.

The court agreed with the first instance findings that if a solicitor has done what is necessary to accrue a right to a fee, an award for damages in the amount of the fee payable constitutes a loss under a professional indemnity policy. In this case the fee belonged to Tughans in law and equity; and the agreement for the fee had not been rescinded by Brown Rudnick, therefore Tughans' contractual right to it remained valid.

Some of the key points arising from the decision are set out below.

On policy wording, the court emphasised the breadth of the insuring clause – covering "any civil liability" – and did not distinguish between liability for damages for fees paid to the firm and other forms of liability.

Insurers relied on the indemnity principle – that a party cannot recover more than its loss – and that success fee repayment should not form part of its loss. The court held the indemnity principle did not assist insurers and made the following points:

1. Where a solicitor has earned a fee and consideration has been given for it, the solicitor is contractually entitled to that fee and suffers a loss if required to return it as part of the damages payment.
2. The purpose of solicitors' compulsory professional indemnity insurance is to ensure they have the financial resources to meet liabilities. It would be contrary to public interest to narrow cover as suggested by insurers.
3. The commercial and regulatory function of compulsory professional indemnity insurance is to protect innocent partners and employees. The alleged fraud of one partner should not deprive innocent parties of insurance.
4. Allied to this, the policy was composite in nature, comprising individual contracts with each of the partners named in the policy. Each of the insured partners was potentially liable in full for the damages claim and was thus entitled to an indemnity.

It was critical in *RSA v Tughans* the firm had earned the success fee in dispute. The insurer's indemnity principle argument would have been stronger if the fee had been paid without being earned.

The Court of Appeal made clear the question of cover for a claim for return of fees by an insured firm is more nuanced than previously thought. While the case is likely to leave a sour taste in insurers' mouths, it will be interesting to see how the law – and policy wordings – develop. In this respect, professional indemnity insurers that are not constrained by minimum terms (such as excess layer insurers) might wish to consider the breadth of their wording carefully.

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