Sub-prime suspects

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How can a sub-prime lender be defined for the purposes of professional indemnity insurance, asks Lance Rigby?

According to an article in Insurance Times , the sub-prime lender UK Acorn Finance is seeking ?14m plus interest from the insurer Markel in relation to professional indemnity insurance (PII) claims made against a party insured by the latter, Colin Lilley Surveyors, that is now in liquidation. The coverage suggests that Markel is attempting to void the claims because it alleges that the surveying firm failed to disclose that it was working for sub-prime lenders when it renewed its PII policy in 2013.

Questions about surveyors doing work for sub-prime lenders were widely adopted by PII providers following the global financial crisis, in the belief that such lenders were more likely to make allegations of negligence against surveying firms. These questions are still in use, with most forms asking ?Do you undertake work for sub-prime lenders??

Identification

A list of lenders that insurers define as ?sub-prime? has never, so far as we are aware, been developed or distributed. So what exactly is a sub-prime lender? And how can a surveying firm know whether they have carried out work for such an organisation? We believe that the lack of a precise definition or list means many surveying firms are saying that they do not undertake such work. In the light of the Markel case, this could lead to further attempts by insurers to void claims.

In addition to the danger of claims being voided, some insurers are trying to apply higher excesses to the work undertaken for lenders they believe are sub-prime. If a list of sub-prime lenders were distributed by insurers, surveying firms could make a proactive decision about their clients, taking account of the potential impact of a higher self-insured excess. In the absence of such a list, surveying firms are not only in danger of being accused of non-disclosure, they will also find it impossible to measure risk against reward accurately given the likelihood of a higher self-insured excess being retrospectively applied.

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Insurance underwriters seem to base their definition of ?sub-prime? on the type of lending being done, automatically classifying, for example, bridging loans as sub-prime. Historic claims data partially supports this approach, although not all short-term loans can be classified as sub-prime and some short-term lenders will also lend to non-sub-prime borrowers, so the application of a higher excess across all work done for a particular lender seems unnecessarily punitive.

Furthermore, this approach does not take account of the party to whom the lender is lending, how the lender is funded, and the sort of property to which the loan relates. All of these factors must be considered to give an accurate assessment of whether or not a loan is more or less likely to result in repossession, which is the ultimate object of PII underwriters? concern.

Even when all these questions have been answered ? which is impossible without an explicit understanding of each and every lender?s lending criteria ? there remains a danger that the true extent of sub-prime lending is only revealed in a financial crisis, at which point the term would have to be applied retrospectively. Remember that a PII policy covers work done over many years beforehand.

Until surveying firms are in a position to answer the question about work for sub-prime lenders accurately, we believe it should be removed from PII proposal forms. We also feel that RICS should review the minimum PII wording to water down exclusions that relate to non-disclosure on sub-prime lending.

Data

As to how insurance underwriters better measure risk, this all comes down to data and the way that it is shared between lenders, panel managers, surveyors and insurers. Ideally, the more onerous questions on a PII proposal form would be removed, with surveying firms that undertake lending valuations instead providing an annual report summarising all the work they?ve undertaken in the previous year and gives a risk score to each job. No easy task ? but perhaps there?s a tech firm out there that would like to give it a go?

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Further information

- Related competencies include Insurance
- This feature was taken from the RICS Property journal (October/November 2018)
- Related categories: Construction insurance ; Practice management