

COAG National Legal Profession Reform Discussion Paper: Professional Indemnity Insurance

Introduction

Professional indemnity insurance is insurance that:

*"... indemnifies professional people - accountants, architects, lawyers and others - for their legal liability to their clients and others relying on their advice and/or services."*¹

Professional indemnity insurance is fundamentally a contract of insurance between the insurer and insured whereby a pool of funds is available to the insured to meet the financial consequences of a breach of his or her professional duty (including acts or omissions of professional negligence irrespective of whether the act or omission amounts to innocent mistake, error or professional negligence). Legal practitioners have a strong personal and financial interest in ensuring they hold adequate professional indemnity insurance.

There is also a significant public policy interest in legal practitioners holding adequate professional indemnity insurance, to ensure that the users of legal services are compensated for losses they suffer as a result of a breach of a legal practitioner's professional duty. Consequently, professional indemnity insurance is a matter of substantial regulatory interest.

The Taskforce considers that the framework for professional indemnity insurance must satisfy the following aims:

- the provision of consistent levels of professional indemnity insurance protection for legal practitioners and their clients, regardless of the jurisdiction in which legal services are provided and;
- arrangements which will support seamless national legal practice by practices and practitioners who provide legal services in several State and Territory jurisdictions.

Proposed framework

The proposed framework for professional indemnity insurance for Australian legal practitioners and law practices² involves high level principles being set out in the National Law, together with the more detailed regulatory requirements being contained in the National Rules.

Under the proposed framework the Board would be responsible for developing and maintaining the National Rules. Professional indemnity insurance arrangements would (as they are now) be negotiated with insurers at the State and Territory level. A professional indemnity insurance arrangement that conforms to the National Rules may be approved for the purposes of the National Law, in which case the insurer becomes an "approved insurer".

¹ Australian Competition and Consumer Commission, Public Liability and Professional Indemnity Insurance, Monitoring Report, July 2003 at page 26

² Professional indemnity insurance for foreign lawyers practising foreign law in Australia will be dealt with in a separate Paper.

Objectives of the scheme

The objectives of the proposed framework are:

- to provide for the adequate protection of end users of legal services (including consumers) against the consequences of professional negligence by way of appropriate compensation, including future claims against ceased law practices;
- to provide uniform standards for insurance for legal practitioners in the event of professional negligence; and
- to ensure that all approved professional indemnity insurance arrangements provide both an adequate minimum monetary level of cover, and a minimum level of terms and conditions for all legal practitioners regardless of the State and Territory in which legal practice is conducted and legal services are provided.

The regulatory framework for professional indemnity insurance should also promote the following objectives:

- assist legal practitioners to minimise and better manage the risks inherent in legal practice, with a view to minimising the number of claims on professional indemnity insurance policies;
- ensure approved professional indemnity insurance is available to all legal practitioners and is affordable irrespective of where the legal practice is conducted and legal services are provided; and
- promote constancy in the professional indemnity insurance market so to maintain premium stability.

Legislative principles

The following legislative principles are proposed for the professional indemnity insurance regime. These would be included in the National Law.

The Taskforce proposes that the National Law set out the following principles, which will form the basis upon which National Rules will, where necessary, be developed by the National Legal Services Board.

Principle 1

Unless otherwise exempted, an Australian legal practitioner must not engage in legal practice unless the practitioner holds and maintains, or is covered by, professional indemnity insurance under a professional indemnity insurance arrangement which provides national cover and is approved by the Board for the purposes of the Act.

Principle 2

Unless otherwise exempted, an incorporated legal practice must not engage in legal practice unless the practice holds and maintains, **or is covered by**, professional indemnity insurance under a professional indemnity insurance arrangement approved by the Board for the purposes of the Act.

Principle 3

The Board must not grant or renew an Australian practising certificate unless satisfied that the applicant is, or will be, covered by an approved policy of professional indemnity

insurance for the period of that Australian practising certificate (or is otherwise exempt from this requirement).

Principle 4

The National Rules may exempt a class or classes of Australian legal practitioner or incorporated legal practice from the requirement to hold and maintain professional indemnity insurance.

Principle 5

Where an Australian legal practitioner is not required to hold and maintain professional indemnity insurance, the Board may impose a condition on the Australian practising certificate limiting the scope of legal services that may be provided by the legal practitioner.

Principle 6

Subject to Principle 8, an Australian legal practitioner or incorporated legal practice must obtain and maintain approved professional indemnity insurance in their home jurisdiction.

Principle 7

An Australian legal practitioner is not required to take out professional indemnity insurance in more than one jurisdiction.

Principle 8

Where a law practice maintains an office in more than one jurisdiction, it may arrange professional indemnity insurance for the whole law practice in a jurisdiction in which:

- (a) it maintains a permanent office; and
- (b) at least one principal is a resident, holds a practising certificate that was issued in that jurisdiction, and practises solely or principally in that jurisdiction.

Principle 9

Professional indemnity insurance arrangements and policies that provide insurance to Australian legal practitioners must conform with the National Rules.

Principle 10

The Board may approve a professional indemnity insurance arrangement if satisfied that it complies with the National Rules .

1	LLFG comments:
1.1	The LLFG is supportive of the proposed framework, objectives and legislative principles outlined above.

Background

Legal practitioners are required to obtain and maintain a minimum level of professional indemnity insurance (known as the 'compulsory layer'). In addition many law practices obtain additional levels of coverage over and above the compulsory layer (known as 'top-up insurance').

Historically, the compulsory layer professional indemnity insurance has been linked to a practitioner's practising certificate and as such, regulation of that professional indemnity insurance has also been a matter of State or Territory jurisdictional concern.

The Taskforce notes that in developing the Model legal profession laws the Standing Committee of Attorneys-General considered the question of whether to introduce a single national professional indemnity insurance scheme for legal practitioners (or a standard policy document). The conclusion reached at that time was that each jurisdiction should retain its local professional indemnity insurance arrangements for its local legal practitioners. This position is reflected in the basic rule embodied in the various *Legal Profession Acts* that a legal practitioner must obtain professional indemnity insurance through the professional indemnity insurance scheme that operates in his or her home jurisdiction.

The Taskforce proposes these basic features of the professional indemnity insurance framework be maintained.

National Rules for Professional Indemnity Insurance

Under the new regulatory framework, the National Legal Services Board will be responsible for developing uniform National Rules in relation to various areas of legal profession regulation, including professional indemnity insurance.

The Taskforce notes that the Standing Committee of Attorneys-General has referred to it the issue of proposed national standards for professional indemnity insurance for consideration. The Taskforce proposes the following standards be incorporated into the National Rules to be developed by the Board, as Rules that must be satisfied before a professional indemnity arrangement may be approved for the purposes of the National Law.

Rule 1 Provision of cover – Australian legal practitioners and law-practices

National cover may be underwritten on a 'per law practice' or 'per Australian legal practitioner' basis.

Rule 2 Nation-wide cover

National cover shall provide indemnity for the private legal practice of the law practice in relation to the provision of legal services within Australia.

Rule 3 Scope of services to be included in cover

National cover shall extend to civil liability incurred in connection with the legal services of a law practice and persons engaged by the law practice in the provision of legal services.

Rule 4 Claims made cover

National cover shall provide indemnity for claims actually made during the period of insurance which arise from the insured's law practice or circumstances from which a claim arises which are notified during the period of insurance.

Rule 5 Sum insured

The minimum amount of indemnity under the national cover shall be \$1.5 million for each and every claim or each and every loss inclusive of claimant's costs and defence costs.

Rule 6 Former principals and those formerly engaged by the law practice

National cover shall provide indemnity for any former principals of, or those formerly engaged by, the law practice and by any prior law practice of the insured.

Rule 7 Ceased law practices and Australian legal practitioners

National cover shall provide indemnity for run-off liabilities of a law practice which ceases by reason of death, retirement or otherwise for a minimum of seven years.

Rule 8 Innocent person protection

When a claim arises from dishonesty or fraud, national cover shall not exclude indemnity of a principal of or person engaged by, a law practice who was not knowingly connected with any dishonesty or fraud related to the claim.

Rule 9 Fidelity Fund claims

National cover is not required to but may provide indemnity to the extent that the subject matter of the claim entitles the claimant to claim and to receive compensation from a fidelity fund, guarantee fund or similar cover provided by a regulatory authority or law society in accordance with State or Territory legislation.

Rule 10 Non-avoidance cover

National cover shall not provide the insurer with a right to avoid or cancel cover by reason of any innocent or non fraudulent non-disclosure or misrepresentation by the insured.

Rule 11 No Known Circumstance Exclusion

For the purposes of this standard, "Known Circumstance" is a claim or circumstance

- (a). which an insured becomes aware of prior to commencement of the period of insurance; and
- (b). a reasonable person in the position of an insured would have considered that the circumstance may give rise to a claim against the insured; and
- (c). the claim or circumstance was not reported to the insurer or to a former insurer prior to the period of insurance.

National cover shall not contain any provision whereby cover is excluded by reason of a known circumstance.

Rule 12 Retroactive cover

National cover shall provide retroactive cover except for claims arising out of fraud or dishonesty.

The Taskforce invites comments on these proposed National Rules. In particular, the Taskforce would be interested in the views of the Consultative Group and stakeholders on whether or not the minimum sum insured should be increased to \$2 million.

2 LLFG comments:

- 2.1 The LLFG is broadly supportive of the draft national rules.
- 2.2 We see a potential gap between run-off cover schemes if cover is still permitted to be written on a 'per Australian legal practitioner' basis, as expressly contemplated by rule 1. We support all schemes, including the run-off cover component, operating on a 'per law practice' basis.
- 2.3 We are supportive of the minimum sum insured being increased to \$2million. We understand that to be the level of the primary cover now provided by each of the State and Territory schemes.
- 2.4 We would want to have the opportunity to comment on some technical and drafting aspects of the proposed rules before they are finalised.

Multi-jurisdictional law practices

Presently, in certain circumstances a legal practitioner may be granted an exemption from the requirement to obtain professional indemnity insurance in his or her home jurisdiction. This occurs where the legal practitioner is a member of a law practice that engages in legal practice in several jurisdictions and the law practice has arranged professional indemnity insurance cover for its legal practitioners in another jurisdiction in which it engages in legal practice.

The Taskforce proposes to adopt this approach in a simplified form. Where a law practice engages in legal practice in several jurisdictions, the law practice should be entitled to obtain professional indemnity for the whole of the law practice in one of those jurisdictions, provided that the law practice maintains a permanent office in that jurisdiction and a principal of the law practice (who holds a practising certificate that was issued in that jurisdiction), is a resident of the jurisdiction and engages solely or principally in legal practice at that office. This would remove the present requirement for legal practitioners and law practices to obtain exemptions in each other jurisdiction in which they practice.

The Taskforce notes that what constitutes legal practice 'in several jurisdictions' will need to be defined. The risk to be managed is that sham multi-jurisdictional law practices may be established to enable "jurisdiction shopping" for professional indemnity insurance cover that exploits terms that the practice regards as the most advantageous notwithstanding its particular risk profile and claims history.

The proposed test is that the office is maintained on a permanent basis, and that legal services are regularly provided from that office. In practice, the Board would have a discretion to determine whether a law practice is engaging in legal practice 'in several jurisdictions'.

There needs to be management of the risk flows from the nexus between professional indemnity insurance premiums, the number of practitioners covered by a particular scheme, the claims history and risk profile of the insured population and the size of the risk pool needed to meet anticipated

actuarially determined claims. Premium stability and availability of affordable coverage are key considerations.

3 LLFG comments:

- 3.1 We are supportive of this general approach.
- 3.2 It may restrict flexibility for incorporated legal practices with a small board of directors – one of the directors needs to be a resident practising in the jurisdiction in which the ILP wishes to insure. Nevertheless, we recognise that there is inherently a trade-off between flexibility for multi-jurisdictional practices and maintenance of the viability of the smaller schemes.
- 3.3 The same general approach should extend to federated or associated firms or incorporated practices – such that each member of the federation or association can insure in the jurisdiction in which a principal of another member meets the residency/practising requirements of Principle 8.
- 3.4 The Discussion Paper does not address the situation of law practices which operate principally outside Australia. Such practices may have international PI arrangements which meet all of the requirements of the Rules (including in relation to run-off cover), but are not with one of the 'single supplier' schemes in Australia. We suggest that a mechanism be considered to address this situation which strikes an appropriate balance between the competing considerations referred to in paragraph 3.2 above.

Maintaining the National Standards for professional indemnity insurance

The Taskforce envisages that the National Legal Services Board will establish appropriate arrangements to review and, where necessary, revise the National Standards that must be satisfied in order for a professional indemnity insurance scheme, arrangement or policy to be approved for the purposes of the National Law.

Ensuring conformance with the National Standards

The Taskforce envisages that the National Legal Services Board will establish an appropriate mechanism to review proposed professional indemnity insurance arrangements to determine conformity with the National Rules.

The linkage between professional indemnity insurance and the grant or renewal of an Australian practising certificate

The requirement for Australian legal practitioners (both barristers and solicitors) to obtain and maintain “approved” professional indemnity insurance is a legislated requirement of the various existing *Legal Profession Acts* (and the counterpart legislation in South Australia). Principle 1 retains this essential requirement.

Professional indemnity insurance is, in a practical sense, very closely tied to the grant or renewal of the practicing certificate. Presently, the obligation to insure generally tends to arise in one of two ways, both of which ‘link’ professional indemnity insurance to engaging in legal practice (which requires an Australian legal practitioner to hold a current practising certificate).

In most jurisdictions, a practising certificate cannot be granted or renewed unless the applicant produces evidence that he or she is, or will be, covered by insurance. In several jurisdictions, the applicant must establish that they are covered by insurance;³ in some jurisdictions, the applicant must establish that he or she will be covered by insurance;⁴ and in others, the applicant must establish that he or she is, or will be, covered by insurance.⁵ In Victoria and the Northern Territory, a law practice must obtain professional indemnity insurance before commencing to engage in legal practice. Generally, jurisdictions also have an ongoing requirement to hold and maintain professional indemnity insurance during the currency of the practising certificate or legal practice.

The Taskforce considers that a legal practitioner should not engage in legal practice unless he or she is covered by professional indemnity insurance. The proposed regulatory framework would achieve this objective by providing that a legal practitioner must not engage in legal practice unless the practitioner holds or maintains professional indemnity insurance (Principal 1), and that a practising certificate cannot be granted or renewed unless the applicant produces evidence that he or she is, or will be, covered by insurance (Principal 3). As is the case in several jurisdictions, the National Rules could provide guidance to the Board in determining what is acceptable evidence that an applicant 'will be' covered by insurance.

The Taskforce expects that the Board will work closely with professional indemnity insurance providers to ensure that the dual objectives of continuity of legal practice and continuity of protection through professional indemnity insurance can be maintained.

Exclusions from the general obligation to insure – Australian legal practitioners

At present, certain Australian legal practitioners may be exempted from the requirement to hold and maintain professional indemnity insurance. In some jurisdictions the categories are set out in legislation and include, for example, Government legal officers and in-house counsel employed to give advice to a corporate employer. In other jurisdictions exemptions are granted on a discretionary basis.

The Taskforce considers that provision should be made in the National Law to enable certain classes of legal practitioners to engage in certain kinds of legal practice without being required to hold professional indemnity insurance, but it does not favour prescribing these classes or forms of legal practice in the legislation.

Principle 5 proposes that the National Rules will provide for exemptions for a class or classes of Australian legal practitioner or incorporated legal practice, or forms of legal practice engaged in by an Australian legal practitioner or incorporated legal practice, from the requirement to hold and maintain professional indemnity insurance.

Run off cover

The provision of run off cover forms part of the coverage package presently required under professional indemnity policy cover – i.e. cover in respect of former principals, other employees or other firms that have ceased engaging in legal practice, particularly in situations where there is no successor practice providing run off cover.

³ See South Australia and the Northern Territory.

⁴ See Tasmania and Queensland.

⁵ See NSW, Western Australia and ACT.

Run off cover insures against claims in relation to events that occurred during the period of the primary policy, but which do not give rise to a notification or claim until after the Certificate of Currency for the policy has expired.

Run-off cover usually applies for a fixed period after the primary policy expires. It is often calculated by reference to the limitation period for professional negligence actions in State and Territory limitations legislation.

The Taskforce considers that the period run-off cover should be provided for is a minimum of 7 years, as recommended by the Professional Indemnity Insurance Joint Working Group (National Standard 7).

4 LLFG comments:

4.1 Run-off cover is provided in Victoria and New South Wales (and perhaps other States and Territories) under profession-wide arrangements for ceased law practices.

4.2 As indicated above, there may be gaps in run-off coverage if primary cover, and the run-off cover provided in conjunction, are written on a 'per practitioner' basis rather than a 'per law practice' basis.

Minimum level of compulsory insurance

The “compulsory layer” of professional indemnity insurance refers to the minimum level of cover that must be obtained pursuant to legal profession regulatory laws. As part of the National Model Laws project, a proposed minimum level of cover per claim has been developed; this is \$1.5 million per claim⁶, although some insurers will offer higher levels of coverage for the same premium, depending upon market conditions.

The Board will be expected to determine from time-to-time that the minimum level of cover be adjusted having regard to, for example, whether the minimum amount provides an adequate level of consumer protection.

Terms and conditions of professional indemnity insurance policies

The Taskforce does not propose that there be detailed prescription of the terms and conditions that must be included under an approved professional indemnity insurance arrangement, provided the requirement that the terms or conditions of the arrangement conform with the National Standards is satisfied.

The Taskforce does, however, envisage the Board will need to make National Rules where it considers such rules are necessary to further the objectives of uniformity, a national legal profession and consumer protection.

Such rules might, for example, identify additional persons or entities that must be covered under a professional indemnity insurance arrangement such as consultants, locum tenens or secondees (to

⁶ Proposed National Standard 5.

or from) a law practice, a prior law practice or defunct law practice, or service or administration companies carrying out activities in connection with the law practice.

Such rules might also identify activities that are appropriate to be undertaken as part of legal practice for the purposes of the scope of insurance cover. These activities may include, for example, involvement in the business migration program, acting as the receiver of the files of a firm of solicitors, acting as a mediator or arbitrator, or in other forms of dispute resolution, activities undertaken in the capacity of office bearer, committee or board member in respect of an unincorporated association, charity or similar entity; or *pro bono* work by honorary lawyers who are members of ethics committees of organisations such as public institutions, hospitals and universities.

Top-up insurance

Many law practices, particularly those undertaking work for international clients, working in high risk areas or where the financial value of the transaction being managed is substantial, will obtain additional professional indemnity insurance cover (known as ‘top-up’ cover) over and above the compulsory layer.

Although it is now possible to obtain a topped-up extension to the compulsory professional indemnity insurance policy, top-up cover is usually obtained from the commercial domestic or international insurance markets.

The Taskforce considers that a decision to take out top-up cover is a commercial decision for the law practice concerned and its clients and therefore is not an area where National Rules are required.

Arranging and negotiating ‘approved’ professional indemnity insurance

Most law societies and bar associations (other than Victoria) retain as part of their existing regulatory functions, responsibility to ‘arrange’ for approved insurance in respect of practising certificate holders within their jurisdictions.

The law societies in Queensland, New South Wales and Victoria and the Victorian Bar rely on insurers specifically set up to provide professional indemnity insurance programs under captive schemes for the legal practitioners within those jurisdictions.

The Queensland Law Society and the Law Society of New South Wales ‘approve’ insurance policies for local solicitor-practitioners with dedicated captive insurers, whereas in Victoria, the Legal Services Board established the Legal Practitioner Liability Committee (‘LPLC’) to provide for the compulsory layer professional indemnity insurance requirements of solicitors and, since 2005, the barristers of the Victorian Bar.

While there are variations on a theme, the balance of law societies and bar associations arrange ‘approved’ insurance from ‘market’ insurers.

In New South Wales and South Australia, the relevant Attorney General also approves the type of professional indemnity insurance policies, the level of insurance provided by the policies and the terms of the policies which can be offered to the New South Wales Bar Association and South Australian legal practitioners (solicitors and barristers scheme) respectively. In NSW, the Attorney-General also approves the type of professional indemnity insurance policies, the level of insurance and the terms of the policies that can be offered to solicitors by LawCover (the captive insurer).

The Taskforce considers that under a uniform national framework the Board will have responsibility for approving professional indemnity insurance schemes (and maintaining the National Standards) for the purposes of the National Law (Principle 10). The Taskforce anticipates that, consistent with its proposed regulatory framework, each State and Territory would retain responsibility for arranging “approved” professional indemnity insurance from insurers.

National competition policy considerations

No Australian jurisdiction has deregulated its professional indemnity insurance requirements to the point where legal practitioners are free to shop individually at large for insurance.

As mentioned above, in some jurisdictions, such as Queensland, New South Wales and Victoria, solicitors (and in Victoria, also barristers) are indemnified under “captive” arrangements. In other jurisdictions professional indemnity insurance is required to be taken out either under a master policy negotiated with general insurers, or with certain approved general insurers under an arrangement negotiated by the relevant authority with those insurers.

National competition policy principles require that legislation should not restrict competition unless it could be shown that the benefits of the restriction to the community as a whole outweigh the costs, and the objectives of the legislation can be achieved only by restricting competition.

The Taskforce notes that previous, detailed reviews of the “captive” professional indemnity arrangements in both New South Wales (2001) and Victoria (2004) did not establish a case for moving away from the “single supply arrangements”⁷. In Victoria for example, the review established that the existing captive scheme best achieves an appropriate balance between providing adequate consumer protection and ensuring stable and affordable professional indemnity insurance cover for legal practitioners, resulting in a net benefit to society and therefore, was not in breach of competition policy.

The Taskforce does not consider the fundamentals of the insurance market or the arrangements for professional indemnity insurance have changed to warrant a re-examination. The Taskforce invites comments on this issue.

5	LLFG comments:
5.1	We accept that the 'single supply arrangements' are the preferred model for the purposes of this national reform process. Nevertheless, the legal services market is evolving, so these arrangements should be kept under review to ensure that the most efficient and cost effective PI insurance market is available to legal practitioners within the dictates of appropriate consumer protection.
5.2	The position of law practices which have international PI arrangements warrants further consideration - see comment 3.4 above.

⁷ Also, section 3.5.5 of the *Legal Profession Act 2004*(Vic) provides that for the purposes of the Trade Practices Act 1974 (Cth) and the Competition Code, the entering into and performance of a contract of professional indemnity insurance by a law practice and the Legal Practitioners’ Liability Committee is specifically authorised by that *Legal Profession Act*.

