PROFESSIONAL INDEMNITY INSURANCE TRENDS NEW ZEALAND AND OVERSEAS

by
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Introduction

My topic is Professional Indemnity Insurance trends, New Zealand and overseas. I am sure the controversial trend has been the increasing cost to the profession since 1960.

I hope to give some opinions and facts on the reason why these costs have risen, and describe the very active steps which have been taken world wide by the professions, their brokers and insurers to provide cover at a cost which fairly measures the risk.

Winston Churchill is said to have described insurance as the magic of averages that comes to the rescue of millions.

The past 10 years have been very much a "learning period" for the professions and the insurance market regarding Professional Indemnity and I believe a major problem in New Zealand is that the averages have not been calculated over sufficient numbers or over sufficient years to give any real benefit.

We estimated a few years ago that only about 50% of the firms in New Zealand were insured at all, and then for very modest figures.

Today, I would expect some professions to be 80 - 90% insured with the consequence that sufficient statistical data should become available to even out the humps and hollows.

But this can be no magic wand and it is going to take continuing effort from all parties to build on the lessons learned to date, and be prepared for the lessons yet to be learned in this evolutionary and uncertain world.

And what lessons have been experienced? I can tell you that 30% of the firms of one professional group in New Zealand have a history of circumstances which have, or could have given rise to claims (and I quote), "against them for breach of professional duty by reason of negligent act, error or omission . . ."

The statistic of 30% arises from a study of the professional indemnity insurance proposals of about 400 firms, and the words quoted, are from the operative clause of the one of the standard professional indemnity policies. As of interest two smaller groups show claims circumstances in 41% of their proposals for one profession, and a very creditable record of 11% in the other. These are 3 relatively major professional groups.

As a feature of modern life, protecting the goodwill and livelihood of the professional firm as well as the interests of the client who suffers loss from the negligent act of his adviser, it is important to appreciate that the insurance covers liability at law – not moral liability, and the circumstances revealed by these proposals have frequently resulted in unavoidable claims of magnitude.

Underwriting Attitudes

I have chosen the following quotation from an insurance publication, to set the scene for this discussion on trends during the past 10 years:-

"Professional indemnity is not a class of business which is sought by insurers because of the problems of underwriting and claims settlement to which it gives rise."

Many reasons contribute to this attitude. One is that the cover is wide under a professional indemnity policy not being limited to claims for bodily injury or property damage as is the case with the well known public liability policy.

Another is that insurers do not wish to become involved too much with what may be called the business or trading risk. They are prepared to cover a claim due to some accidental or fortuitous event, for example, some foreign body entering a product during manufacture, but they are reluctant to become involved in covering business knowhow.

This is a reason that the majority of standard public liability policies and their product extensions, exclude liabilities arising out of errors in advice, design or specification. The implications of this exclusion are not adequately appreciated by the business community at large.

The professional indemnity insurer does cover business knowhow, and is virtually guaranteeing the competence of the insured.

The underwriting manual of one substantial insurance company in New Zealand contains the following instruction:-

"We emphasise that we are not willing to write professional indemnity insurance except for solicitors and accountants where underwriting factors permit insurance except for solicitors and accountants where underwriting factors permit and where there are good commercial reasons for so doing."

This specific quotation also demonstrates the much wider attitude among insurers and, I trust the comments which follow will give some understanding why brokers and practitioners have had difficulty in finding willing underwriters over recent years.

Some History

Historically, professional indemnity insurance is regarded as having been introduced by Lloyd's in the 1920's. There was little demand for cover, and few problems with premiums until the 1960's when legislation, complexity of modern business, publicity of claims and a developing claims consciousness of the public brought about drastic changes to the insurance world.

Many professional Societies and Institutes became aware of a hardening in the attitude of insurers towards professional indemnity insurance, and undertook detailed surveys of their members. Reference to the 1963 survey of one of our larger schemes shows there was widespread interest by members, but a marked lack of consistency in their insurance arrangements.

The survey, carried out 10 years ago, disclosed that sums insured ranged mainly between $4,000 and $20.000 with a nominal few members having covers of $20,000 to $50,000.

Today, a similar survey reveals sums insured ranging from $30,000 to $2,000,000, with the majority maintaining policies of $50,000 to $100,000. In my view $100,000 should be the minimum.

In 1963, the premium range was from as low as $7.50 for a cover of $10,000 in one case, to $200 for $50,000 in another. Today we see premiums ranging from $150 to $10,000 or more in this scheme.

In other New Zealand professions, modern premiums quoted can range from $100, to in excess of $40,000 per firm.

During an 8 year period of the scheme, a claim was recorded for every 4 clients. Many of these claims were very small, and in line with most other professional indemnity schemes, a compulsory excess of $1,000 was introduced.

Many similar schemes require the firm to carry varying proportions of each claim. One Australian scheme requires a contribution of $2,000 and another international arrangement in which some New Zealand firms participate, sets the amount at US$25,000.

Under current conditions the insurance market will be more flexible on this issue, but there has been a strong feeling in the Societies themselves to maintain the provision of a mandatory excess of at least $1,000 to ensure the maximum effort by the practice in its risk control.

As a result of these trends, some practitioners have developed groups and funds to share the cost of any policy contribution incurred by a member. Such groups frequently involve themselves in claim consultancy to aid members, and if necessary, I presume they would take disciplinary action.

These groups have thus embarked on a limited form of co-operative underwriting in conjunction with the insurance market and will share the fortunes of claims experience which follow.

Their loss potential for any one claim is limited but their major risk is the possibility of a series of claims in one year. Recent history has not helped define this risk or occasion alarm and I know of only a few cases which might have had an adverse effect, such as, for example, where more than one claim has been notified by one firm during any one year. In one bad case there were a series of claims against a firm as a result of a partner's illness and even now a few have not yet been fully revealed.

Some Claim Causes

In considering the number of notified claims, it should be remembered that each one represents the circumstances of an error, or an alleged error, which could be quantified into any amount at all. From an underwriter's point of view, the disclosure of the frequency of claims in a practice gives serious ground for concern. Mr Vautier has expanded on some specific cases. I hope to expand on others a little later.

You may well ask what type of claim occurs. Incidents of error or negligence can occur in everything that is done in the practice. Of utmost worry to the underwriters have been occasions of gross negligence amounting to recklessness, where for example one practitioner advised a client to commit an illegal act.

In other cases, practitioners have advised clients to undertake speculative investments, and in others where the practitioner has informed clients that they are insured against professional negligence and generally encouraging them to make claims.

An activity of concern, which to some degree appears to be diminishing now is where an adviser has been acting for two interested parties.

A recent study of our records of a scheme was aimed at categorising the causes of claims. I believe similar information will be revealed in other professions and one significant area in all practices will be failure of basic management or administration methods.

The scheme reviewed showed 31.4% of claims circumstances notified arose from causes such as:-

failure to communicate with clients
failure to supervise
inadequate filing systems
breach of confidence
inadequate diary control

Last year, in a similar address, I said that a number of possible claims have been recorded for estimates in the vicinity of $60,000 to $70,000. Today, this range must read $70 - $80,000, an odd one up to $200,000, and a number in the vicinity of $30,000.

Thus we see the gradual scaling up of exposure. And many of these circumstances have resulted from relatively ordinary activities, in relatively ordinary practices.

The Changing Scene

In January 1971, the world professional indemnity market underwent a substantial review. This affected all professions in New Zealand, and some are still reeling from the effects. Liability reinsurance agreements were amended to exclude or restrict the risk of professional liability claims on the reinsurers, and the few specialist underwriters left, completely updated their rating structures and underwriting methods.

These events resulted from a loss of insurance capacity and world wide reaction to publicised claims such as the Australian case, ***Pacific Acceptance*** v ***Flack & Flack.***

This case incidentally appears to be one containing a similar mismanagement ingredient to those mentioned previously. I have seen the claim described as having arisen out of failure to check that mortgages were executed and registered as intended and to check that a solicitor was instructed to act in the transaction. The claim was settled for $1,500,00 (plus costs reputed to be an estimated $500,000).

In New Zealand, a recent case remembered as receiving wide publicity is ***Bevan Investments*** v ***Blackhall and Struthers,*** which arose from defects in a squash courts construction at Porirua and was settled late last year for $129,000. The original claim was for $185,000. Knowledge of these events has an unsettling effect on insurance underwriters who cannot help looking over their shoulders when figures of this magnitude are being displayed to other potential claimants.

The Increasing Scope for Liability at Law

For many years, there has been the fond hope, that New Zealand claims experience would prove to be superior to those of overseas. To some extent, particularly in the size of recorded claims, the signs are promising. Nevertheless, it is proving more and more difficult to separate our position from that developing overseas.

Local practices are engaging more and more with international connections and this naturally insinuates many overseas attitudes into our local scene where for example, we have a claim from an overseas parent company against a New Zealand practitioner for alleged negligence in attending to the affairs of a local subsidiary.

Thus has the scope of potential liability increased progressively. Court decisions, such as ***Hedley Byrne & Co. Limited*** v ***Heller & Partners Limited,*** changes in modern business and professional techniques allied with greater complexity of work undertaken by the professional firms have all contributed to the changing insurance scene of the past years, in New Zealand and elsewhere.

The ***Hedley Byrne*** case altered a traditional feature of professional liability insurance. When the Professional Indemnity policy was originally devised the professional man was liable only under contract to his client. The ***Hedley Byrne*** case established that the professional man who gives guidance to others owes a duty of care not only to the client who employs him, but also to others who are relying on his skill to save them from harm. And so the scope of cover needed is wider tha iinitially contemplated.

A recently reported U.K. claim for an amount in excess of $2,000,000 further exemplifies this principle. This is also against an accountant, who, it was alleged, had persuaded a bank on the basis of draft accounts to advance money to a building contractor who subsequently went into liquidation. The claim was against the accountant for recovery of the monies loaned by the bank.

The trend continues in New Zealand and we have claims circumstances on record involving claims from parties not clients of the insured, thus firmly establishing the effects of ***Hedley Byrne*** in New Zealand.

Case law is still increasing professional liabilities, and the cost of claims. Fundamental changes in recent years increasing the cost of claims included the allowance for interest on damages. ***"Dutton and Bognor Regis United Building Company Limited"*** of 1971, for the first time sustained a case against a District Council and it's surveyor for negligence in approving foundations on a reclaimed rubbish tip which subsided causing a wall to collapse.

This raises the issue of commercial employers of professional men, and also the personal liability of the salaried professional man. It is uncommon for a commercial organisation to insure, or to find insurance readily available for the risk of professional liability claims.

But how many could be exposed to claims through the special activities of their accountants, solicitors, architects and engineers? And how many of these employees have their special skills relied upon by others, and attract a personal liability?

Some commercial organisations do seek cover, but this is rare indeed, as it is for the employed professional to obtain indemnity for his work outside in secondary employment or voluntary work.

Creditors and others losing money on investments are more and more seeking recovery from anyone possible. In the case of bankruptcy, the auditor, secretary, accountant or solicitor may be the only solvent source of possible recovery left. This is certainly happening in New Zealand as well as overseas.

As case law and commercial practice changes so does the work and responsibility of the professional man. The accountant is giving financial advice,

or acting as a management consultant, the architect is doing work bordering on that of the engineer, and the solicitor is acting as a director of companies and fringing on the commercial field, to name but a few.

The development of umbrella partnerships and agency arrangements with resultant inter-partnership liabilities provides a complicated challenge to underwriters and the firms involved.

Thus the scope for claims has widened considerably. The underwriter too often finds he is insuring a liability newly imposed by the courts or the new venture of the professional man which he never envisaged and without any idea of the implications.

The Capactity Problem

Now I will refer to the problem of premium cost in relation to the capacity of the insurance market to accept risk. Briefly, where there is capacity to place insurance, there is competition. And where there is competition, there is hope for lower premium.

During the past 10 years the world wide insurance market has been severely shaken with widespread losses of profitability. In a nutshell, that was the problem in 1971 when markets collapsed and premiums escalated.

There was a dramatic loss of capacity, and therefore a reduction in the number of insurers available to underwrite professional indemnity insurance.

The capacity problem existed, and to some extent still exists in all major industrial countries of the world, affecting all classes of insurance and reinsurance.

And why does a capacity problem exist?

I have seen the following given as a simple reason:—

> "Capacity is a mathematical function of risk capital. The return on the risk capital of the insurance industries of the most sophisticated countries has been pitifully low for many years and operating profits have in the main been derived from healthy investment income offsetting poor results."

And what brings about the lack of profitability, capacity, and higher premium cost?

Broadly speaking it will be adverse claims experience and increasing expense cost factors.

The expense factor needs no elaboration being the common malady of every business.

Adverse loss experience appears to arise from the rapid development of new manufacturing, scientific professional and management techniques, allied with the sophistication of equipment which brings about more intense accumulation of values and consequent exposure to major loss. These developments, allied with the legal decisions imposing unforeseen liabilities such as ***Hedley Byrne,*** could, from time to time, outstrip the knowledge of both insured and insurer, and a commonly expressed opinion has been that a good deal of experimentation has been done at the expense of insurers.

Certainly the introduction of new materials and construction ideas has been the "Archilles Heel" in some architectural and engineering claims on record in New Zealand.

The Effect of Reinsurance

The capacity problem of the mid 60's has produced an interesting trend in the world wide insurance market through the closer oversight by reinsurance companies. In fact we have ourselves negotiated terms with reinsurers upon whom the direct underwriter relied for guidance.

The reinsurer has had the same problems as the direct underwriters, and has pursued the same solutions.

Changes in reinsurance techniques have also affected the capacity of underwriters to underwrite professional indemnity insurance.

A major company in New Zealand at one time had reinsurance treaty facilities which paid for claims in excess of $10,000. New arrangements require the local company to retain $200,000 before having the protection of reinsurance. This means the local branch manager would have to commit his branch to a liability of $200,000 for isolated cases of an acknowledged difficult class of business, and one in which he would have little if any experience.

He will therefore not accept the risk because the skilled underwriter is aiming for a balanced book, which implies that he is trying to avoid big exposures, or at any rate not over extend to the point of exposing his account to shock losses.

The Remedial Action of Insurers

Can we now look at the remedies the insurer can take to restore both capacity, profitability, the confidence of his reinsurers, and ultimately stabilise premium cost to the benefit of the insured.

Mergers

One answer has been to merge companies. We have seen a number of these over recent years, resulting in rationalisation of corporate expenses and assets. But mergers have appeared to ***reduce*** risk taking capacity, competition, and consequently the scope for independent thought and enterprise, much needed elements in the writing of Professional Indemnity business.

The Individual Underwriter's Solutions?

My own view is that the solution to profitability usually comes down to the individual underwriter, or the branch manager, the one person vested with the responsibility to make a profit for his company, and with a desire to gracefully reach retirement and draw his pension.

He anxiety is to keep his house in order and he will therefore follow certain courses of action.

For example, he will endeavour to increase rates. He will scrutinise exposure and select risks much more carefully. He will pay more particular attention to the breadth of the cover given by his policy contract.

He will study the expense costs of servicing his business generally and classes of insurance in particular.

Finally, if he cannot get the rates, conditions and expense factor his experience dictates, he will withdraw from participation in the unprofitable or difficult class of insurance.

From this broad outline, and from the experience of the past, professional

indemnity insurance is a class that is first effected. This is because it has a high exposure potential, insufficient background of statistical experience and liabilities which are to some extent still in an evolutionary state.

Specialist Markets do Provide Capacity

Fortunately, specialist markets do provide necessary cover, at terms developed from world wide and geographically defined experience. But how limited is this market? It was reported in 1970 by the Journal of the Institute of British Architects, that there were only two Lloyd's syndicates, and two tariff companies operating actively. This is not necessarily correct today, but the scale of participation is just as minimal both here in New Zealand and overseas.

You will appreciate that this gives very little choice, and very restricted competition. The broker must use all his skill to buy the insurance for his client for the most reasonable cost and terms which is his duty at all times. Nevertheless, from the point of view of security, and stability, it is important that these companies and underwriters continue to build their facilities. As profitability (hopefully) returns to the market, we can expect to see new underwriters venture into the field, but it is important that they plan to "stay the course". It is an unfortunate fact of insurance history, that undesirable fluctuations are brought about by those who dabble for a short time and withdraw or those who extend their capacity and fail financially leaving unprotected clients floundering in their wake.

And I would also quote further from the same architectural journal to show that specialisation does not automatically ensure successful underwriting:-

> "From an examination of the financial returns, the RIBA solicitor can confirm that the Lloyd's syndicates lost far more than £100,000 last year as a result of claims settled exceeding premium received, and this figure takes no account of claims still pending at the end of the premium accounting period."
>
> The RIBA has been advised that the two insurance companies have been facing similar losses."

And so the capacity problem has reflected seriously on professional indemnity insurance and the premiums to be paid by the practitioners.

The Premium Trend

Obviously the underwriter will seek premiums sufficient to meet claims paid and to provide for those which are outstanding.

Until 1969 most premium scales were reasonably level, some increased and others remained static, and some even gained concessions such as for architects for whom we were able to negotiate an improved discount of 30%, which held until the cataclysmic changes of 1971.

The year 1969 introduced the first effective changes particularly for solicitors and accountants as the upward trend of New Zealand claims began to be felt.

For example may I quote from the records of one scheme which shows that since 1969, rating increases have affected firms such as these:-

A firm with one partner, 2 staff – indemnity $50,000
in 1965 paid $146.00
in 1969 paid $174.00
in 1972 paid $337.00
A firm with 4 partners, 13 staff – indemnity $100.000
in 1965 paid $338.00
in 1969 paid $517.00
in 1972 paid $836.00

Incidentally, for this profession, the 1972 premium took an average 95 cents of each $100 of gross fee earned.

I am pleased to say that the 1973 figures have remained stable, but this is a feature very much under review by both Societies and underwriters.

The Problems of Premium Rating

At this stage, it is submitted that underwriting experience has not yet been gained over a sufficient length of time to provide adequate data to achieve true stability. While we do consider it desirable to isolate New Zealand experience, we must remain aware that purely local schemes may prove to be over sensitive to the effect of major claims through lack of premium volume.

A leading underwriter has stated that in his view a 5 year picture is required to judge the approximate ratio of claims to premium, and that even this should be adjusted to reflect results from the last three years, together with, we might add, the prognostications for inflation over the forthcoming years.

The following example of a local liability insurance fund may help demonstrate the unpredictability of a short period comparison. The figures were calculated at irregular intervals at critical times of review and negotiation, and indicate the extreme fluctuations arising from claim notifications that upset the most optimistic predictions. I will give you the net loss accumulated each year and the percentage ratio of total claims incurred to net premiums.

The fund built up over a number of years but we will take the last 5 periods during which the various negotiations took place:-

Period 1 Net Loss ($5,000) Loss Ratio – 107%
Period 2 Net Loss ($38,000) Loss Ratio – 130%
Period 3 Net Loss ($162,000) Loss Ratio – 170%
Period 4 Net Loss ($127,000) Loss Ratio – 149%

At Period 4 the fund ceased accepting business, claims notification ran down, and as claims were received or settled, period 5 came into profit:-

Period 5 Net Profit (+$101,000) Loss ratio – 72%

This was encouraging, but in period 6 we can see the effect of latent notified claims not previously provided for in the estimates. Thus; Period 6 Net Profit ***reduced*** to (+$63,000) (from $101,000) and loss ratio ***increased*** to 80% (from 72%).

Continuation of the scheme at increased rates should have confirmed profitability but as I have said before potential claims of $70-$80,000 are on file and the reserves accumulated need to be more substantial to iron out the humps and hollows in experience.

Other schemes show similar patterns. As a broker, one remains hopeful for the future, but lurking in the back of the mind is an awareness of those inactive claims.

Providing for Outstanding Claims

A real problem in rating therefore, is the delay in settling claims, and thus arriving at true statistical results. In fairness, these delays are rarely caused by underwriters.

After all, the whole question of liability is a delicate one, and requiring a clear analysis of the original act, which might have occurred many years before, to the preparation and proof of claim by the claimant and subsequent negotiation and proof of loss. Following this can be the inevitable delays of court action should this be required.

To demonstrate the time frequently required to achieve justice I would mention the example of a claim in New Zealand arising from arrangements concluded early in 1960, and resulting in a failure in 1970. Legal action was not effected until 1973. *A further action*, depends entirely upon the result of the first litigation which is still in hand. 13 years have now elapsed since the original act of alleged negligence, and the case is far from concluded.

There are others in similar vein, for an example, where contributory negligence is involved. We did have a case where a plaintiff was injured by a falling fixture. The employer paid a fixed amount of compensation and the balance was divided as being the responsibility of the main contractor who paid 50%, the consulting engineer 25%, and the architect 25%. This negotiation was necessarily complex and lengthy.

Thus, the provision for outstanding claims is a major problem in any liability insurance or fund. The prudent underwriter must create reserves to pay claims and he cannot ignore any possibility. He will presumably err on the conservative side.

We have records where the underwriter has assessed that no provision was required, but has subsequently paid a substantial claim. A recent claim notified in 1970, with no provision considered necessary has just "come alive" with an estimate of $20,000.

On the other hand, we have seen a reserve of $120,000 created, only to be dispensed with 3 months later. The loss ratios mentioned previously demonstrate these conditions.

An article in Rydges Magazine puts the position quite vividly:- 364.14."While the $1,000,000 and over cases hit the headlines, there are a dozen cases notified daily in which a claim could arise. Many of these appear insignificant – the majority fizzle out – but there is always the chance that a seemingly minor matter could explode into staggering headlines and the possibility might lie festering in the filing cabinet for years before the participants finally come to blows, stirred to action by the eventual completion of a lengthy and expensive investigation and the looming shadow of the statute of limitations. In cases like these, the underwriters must put away enormous reserves, knowing that while the lawyers are combing and brushing their tactics the eventual bill will more than justify the premiums collected. It can be 10 years and well over before anything like finality looms ahead."

Inflation

In considering the effects of these problems on premiums we should give some thought to the effects of inflation, a major factor of concern.

In calculating his rates, the underwriter must consider claims results, and the levels of cost likely during this year, and future years.

An article in a British Insurance Publication quoted the increase in personal injury claims for the period 1967 to 1970. Serious cases in 1967 were quoted as being $30,000 to $40,000. Whereas in 1970 the same serious case was quoted at $70,000 to $150,000. I believe New Zealand records would be comparable.

In a more modest comparison, a study of one Professional Indemnity scheme in New Zealand shows that for the 4 year period 1966 to 1969, the average cost per claim was $2,000. The average for the next 3 years, 1969-1972 is $4,000 an increase of 200%.

A comparison of the average fees of 150 firms for ***one*** year only 1971/1972 showed an increase of 7%. I have no record of fees prior to 1971 but I presume they would have kept pace with the nominal wage index for professional employees which increased 70% over the period of 1964 to 1971.

I am sure the economists and the accountants will be more skilled at interpretation than I am. General inflation is only one of the factors. Frequency of claims, increasing scope of liability, and the developing skills of claimants to assess their potential award must likewise affect the quantum, and tend to leave the underwriter behind.

Improving Underwriting Information

In their endeavours to develop adequate funds, insurers have stepped up their endeavours to measure the risk, introducing new methods of rating, and stricter proposal questionnaires.

A trend in this respect is the adoption of rating on turnover or gross fees, as compared to numbers of staff. This has the effect of building in an automatic inflation factor, and in addition the fees earned from the different classes of work undertaken by the firm help quantify the more hazardous areas of risk as they are revealed.

Efforts are being made to simplify questionaires but because of the continuing effort required to measure and control risk, adequate information is necessary. As experience becomes more sophisticated one would hope for some relief in this aspect of the insurance.

These detailed questions have in fact resulted in an increasing trend for Underwritiers to require assurances on procedures, or changes of office supervision or systems when they consider proposal answers disclose substandard conditions. This undoubtedly arises from their awareness that mismanagement is a major cause of claims.

Scheme Control & Compulsory Insurance Trends

World wide, professional organisations, with their brokers, have developed schemes to maintain central statistics and claims analysis to give aid to underwriting negotiations, reduce inequalities, and disseminate the lessons learned to their members.

Compulsory insurance has been seriously developed in parts of the world. Most significantly is that currently proposed for the Law Society in the United Kingdom. A Bill has, I believe, received a second reading in Parliament, and this

will no doubt be closely watched by other countries and professions. Insurers and brokers are co-operating with the U.K. Law Society in this venture.

Continuous research is proceeding from the facts being collated. Our United Kingdom and Australian associates together with our company in New Zealand are closely identified with a number of Societies and Institutes. Regular meetings take place with Society Committees to consider the statistical evidence and lesssons being learned.

The type of information unfolding is varied. For example, New Zealand experience and those of other countries is being isolated more adequately and clarified.

Some more claims causes revealed in Schemes

A comparison of causes of claims for Accountants in New Zealand and the United Kingdom discloses the interesting fact that 32% of the United Kingdom claims emanated from taxation errors. Our records in New Zealand contain no claims of this nature.

On the other hand, negligence as a receiver or liquidator works out at about 10% in each country.

Of more particular concern to a wider range of professions in the United Kingdom and in New Zealand is the potential for claims from insurance work.

Public valuers, architects and engineers who engage in valuation work have all been exposed to substantial loss. Errors in the valuation of a subsequently destroyed property have had far reaching consequences.

Accountants, solicitors and dare I say it, insurance brokers, have similar exposures. For example, a fork lift was not inlcuded in a policy, a woman was injured and the claim for personal injury damages was sustained against the accountant who failed to insure on behalf of his client. The Accidents Compensation Act will possibly have a bearing on all professions in this regard as the personal injury side becomes clearer over the years.

It is reported that the interests of a mortgagee were not protected and the solicitor who arranged the policy was held responsible when the claim for fire loss was declined as a result of breach of policy conditions by the owner.

Many practitioners believe they do not engage in hazardous work.

For example, some accountants consider they have no risk if they do no auditing.

And yet we see claims arising from practices of all types and sizes and from all areas of activity.

Accountants or solicitors have been alleged to have made errors as secretaries or directors. As officers of the company they have special responsibilities and I am aware that a number of professional people are concerned at this aspect of their work.

Debt summons have resulted in libel claims. Failures to detect defalcations have occurrred with accountants, and not just auditors. Failure to validate documents is also another frequent cause.

I have mentioned the problems of claims arising from ill health of partners and this could also include staff. This can be a major risk in any business or profession under modern conditions.

The consequences of architectural and engineering mistakes have been well

publicised. Negligence in introduction of new materials and general supervision are common causes of claims, and failure in design seems to be the most frequent.

We have not completely refined our statistics but the following may give some indication to solicitors. About 28% of the number of notified claims circumstances arise from conveyancing work including searches, mortgages, sale and purchase of business and subdivisions. Failure to meet time limits contributes 17%.

Accountants, in a similar survey, show 21% of the number of claims arise from the capacities of secretaries and directors, 32% audit, 10% receivers and liquidators, and about 20% from investment transactions or advice.

Policy Wording Trends

Over the years we have negotiated various changes in policy wordings and currently other innovations are being studied and implemented. For example, and perhaps most importantly is the need for a wider definition of professional capacities to cater for the expanding and modern scope of professional activities. A further point is whether the limitation of the cover to claims in negligence is sufficient, and this is also receiving attention.

Brokers, professional bodies and underwriters are doing their best to develop practical contract wordings. But sometimes I wonder if this is appreciated. Many professional men still tend to ignore the importance of the policy wording and the various extensions which are offered. In fact, the occasional ignorance or lack of concern for the niceties of insurance and basic contract law is alarming.

We still see insurance policies without fully retroactive protection. We have found this extension of crucial importance, as a substantial number if not the majority of claims recorded result from acts which occur prior to the policy period.

There are also some unusual fine print exclusions limiting odd forms of cover offered. We have seen a policy exculde liability if the insured or any employee lose their right to practice, or have declined to belong to a society of their professional brethren, or the act was committed whilst under the influence of liquor or drugs.

I hope there will be an improving awareness of the need for proper contract wording and coverage as Brokers and Societies continue their educational efforts.

Proposal Disclosure

Of equal concern to us is that the professional firm complete its proposal form adequately. That it should disclose circumstances which have caused claims, or which might have caused claims. Full disclosure is essential, and nothing should be withheld. Once again this is a contractual responsibility applying to all forms of insurance, which, if carried out incorrectly, can leave the insured without protection.

Delays in notification of claims sometimes cause a problem and also endeavours by the insured to negotiate without prior reference to the underwriters.

One cannot be too careful. We recently had a case of a client firm which carefully completed the proposal and arranged its insurance. Some time later, a copy of the proposal was circulated to all partners, and to and behold the circumstances of an old claim turned up. This had been completely overlooked, and somewhat belatedly details were provided to the underwriters.

Risk Management in Professional Practice

The concept of risk management, pioneered in the U.S.A. and now evident in New Zealand, emphasising loss prevention and loss control is winning recognition from insurers by way of improved capacity and premium cost in all classes of insurance.

The professions are doing their part as evidenced by this seminar. Advice to members on the use of disclaimers, and limitations of liability are but two examples of the risk management technique in professional practice.

Underwriters have shown willingness to recognise these professional efforts but we often find it difficult to convince them the new innovation is going to be as successful as we and our clients are convinced. You will know how complex the law is on disclaimers. Underwriters have been considering these carefully and one point of interest is the tendency to print too small. I understand case law supports this view but no doubt others are more qualified than I to comment in depth.

I am sure the awareness which has been created will ensure that these efforts at risk management become an automatic part of the training and practice of the practitioner.

Conclusion

I trust I have given you a reasonable interpretation of facts and opinions on the trends of professional indemnity insurance in New Zealand and overseas.

Reduced capacity resulting from lack of profitability in the insurance market, and a paucity of adequate data has restricted the potential for satisfaction over recent years.

This situation appears to be improving and we should look forward to some stability in costs and modernisation of terms as experience dictates.

Most professions are in a relatively unique position in that their various organisations and brokers possess more underwriting information than is customary between insurers and insured, and the extensive efforts to sophisticate records and learn lessons, together with the frank outlook between societies, brokers and underwriters should only result in the development of a fair and equitable relationship.

New Zealand professions have so far evaded the spectacular million dollar claims, but the $100,000 and the $200,000 precedents have occurred. Wise practitioners, conscious of their unlimited liabilities, are taking heed of these trends and continue to improve their systems and methods and finally to insure in greater numbers to cover themselves, and their obligations to protect their clients.

And finally, may I leave you with this one thought. In this rapid changing world we should remember one of the fundamental principles of insurance, that you, the insured are bound to know more about your risk than the underwriter

or broker. If this principle is remembered together with the principle of good faith, then I believe that insurance underwriters and brokers will continue to provide the protection you need.

Thank-you, Mr Chairman.

QUESTIONS ADDRESSED TO MR DONALD

Question:

Mr Ladd:

Mr Donald may be able to tell us whether the solicitor's professional indemnity policy excludes gratitous advice.

Reply:

Mr Donald:

Perhaps I should ask Mr Vautier to define this for us. Mr Vautier did make the observation that gratuitous advice arises only when the advisor carries on the business or profession of giving advice of the kind sought.

When I was in England at the end of 1971 negotiating terms, we did discuss at some length with underwriters the problem of the ***Hedley Byrne*** case and there was a tremendous diversity of points of view in the insurance market as to whether the policy did provide this cover. First they wanted extra premium for it. Secondly, if it is not in it had to be put in.

So far as solicitors are concerned this wording was extended to include"breach of professional duty" which would include breach of professional duty which may be owed other than in contract. So I would presume the gratuitous advice would be acceptable under that part.

Once again, talking specifically to accountants and solicitors who have almost identical wording, the "binding" clause extends this cover to solicitors and accountants whether they bind a person as trusteee, attorney, liquidator or secretary.

The fees form part of the income of the firm. The observation which we made last year which did not arise from any particular case, was the possibility of asking solicitors and accountants in particular, using their talents for charitable organisations or their advice being given in this way, and then being relied upon, in unpaid voluntary work; so in fact we have arranged for that particular situation to come in. There again we did not know if it was intended in the policy. Our advice was "it is better to have it and not need it than need it and not have it."

Mr Vautier:

There is still a grey area in it. The wording is "for breach of professional duty". There are a number of cases which show that for example in the case of solicitors it is not within the scope of their duty as solicitors to give advice on business matters, but of course they constantly do that. The insurer so minded could certainly look those cases out and say it was not within the scope of the ordinary practice of a solicitor to do this and therefore although ***Hedley Byrne*** may apply, the solicitor may still have no recourse under the policy.

Question:

Mr Barnett:

Would Mr Donald give us the difference in the figures a person pays. A doctor pays $50 per person, an engineer may pay $2000?

Reply:

Mr Donald:

Per person? In the figures I did mention that the rating factor depends on the sum insured and the type of work that is being done by the various firms. I did one calculation where we had a rate on the fees earned and that was taken over somewhere about 1000 practitioners, partners in firms, and taken over a variety of sums insured as a level. I will just hark back to these other figures I gave you.

The two firms I quoted here in this particular case; 1972, one partner, two staff, paid $337 for an indemnity of $50,000. The other with four partners and 13 staff paid $836 for an indemnity of $100,000.

That is taken from the legal and accounting scale of rating. Valuers are those who seek similar indemnities generally and therefore are paying appropriately less in comparison with others. The same with Quantity Surveyors. It is a very statistical thing. I don't know whether Mr Adam has any observation there.

Mr Adam:

Impossible to answer because of the number of variants. Not only the type of business. Earlier in the piece Mr Donald mentioned in the course of action "internal diary control".

Mr Donald:

Claims out of time. Injury claims. etc. And that class of thing. You get back to the basic circumstances that somebody has not recognised you must do.

Question:

Mr Salmon:

Commented that in a private practice a partner who cannot attend to his duties, because of ill health must:—

(a) inform his client

(b) arrange for some other practitioner to take over the work.

He asked for clarification of the situation where in a commercial enterprise employees fall ill in their daily life. Is this covered by breach of contract or failure to fulfill?

Reply:

Mr Donald:

The observation we are making here is that the cause of the loss to the client or the person affected is a negligent act. The negligent acts in the cases we have mentioned have arisen during a time when the person was sick. And this would precipitate it.

Queried:

Mr Salmon:

What is negligent in going sick?

Reply:

Mr Vautier:

That is the point. Was there negligence in all of the circumstances? The circumstances must be considered and it may well be that if a man is incapacitated from attending to his affairs he cannot be classed as negligent, but of course if there is something he could have done by getting another person to attend to them then he is negligent.

Mr Donald:

It was difficult to say the particular loss was due to his sickness.

Question:

Mr Haines:

What do you see as meeting the two situations:—

(a) a widening of the requirements of society for protection

(b) the diminishing of the insurance industry to cope with it.?

Reply:

Mr Donald:

I think that is a matter which will be dealt with by the speakers this afternoon. Perhaps you would like to address this to Mr Duncan.

I have noticed in our own company report that the profitability is returning to the market and the capacity is increasing right across the field and a lot is to do with people knowing where they are going and what they are doing. There is an increasing capacity generally in the market now that profitability is coming back and we have seen this in the aviation field where the airlines sought to organise their own insurance companies and found this was not really the answer. They were really doing this because of lack of capacity and the

advent of the jumbo jets but the insurance companies are doing this and in the aviation market it is as competitive as it has been for years.

Question:

Mr Ladd:

What protection is afforded the solicitor who becomes involved in Social Welfare and is required to give advice outside his particular field?

Reply:

Mr Donald:

One of the things getting back to the professional man. This is an area that is certainly receiving very close study in all professions. To make coverage sufficiently wide to cover the man in situations where he contracts in addition to his official capacity. As far as Citizens Advice Bureaux are concerned we have consulted three; one said "no"; the other two took out insurance, and we had diversity of opinion from solicitors as to what was necessary.

Question:

Mr Allen:

Asked whether the solicitor who has an insurance agency and the solicitor acting as trustee or executor in a family trust is covered.

Reply:

Mr Donald:

Generally with reference to insurance agencies. Some years ago when we first had a claim it was clarified by the group of underwriters. They would regard insurance agencies as being part of the work of the solicitor or the accounting firm and the underwriters who took over it would be blind to the fact that solicitors tend to engage in insurance work of varying degrees of interest and it was agreed that this would become part of the capacities. They have become very uneasy over the last two years and have asked for information. This is part of the changing scene. They have agreed that it is covered.

As far as the executor and trustee one is concerned I believe a question was raised in Wellington where the trustee was aware that investments had been made that were not going as well as they should, mainly as a result of his power (again back in general terms) and his question is "now he is supposed to advise beneficiaries that things are not going so well and this shows he is at fault?"

As far as I am concerned, he should consult the underwriters immediately and telex details away to his insurance company.

Question:

Mr Allen:

Asked what would be the insurance situation where the professional is personally involved.

Reply:

Mr Donald:

Underwriters for the solicitors scheme ask the question "Are you a director or shareholder, or have any finance in a company in which you are a solicitor," and where the answer is "yes" underwriters exclude. This does not include solicitor's nominee companies. But they do not actually ask the question of accountants. They ask it of solicitors.

Question:

Mr Coleman:

Asked whether in the future the professions in N.Z. might be able to act as virtually their own underwriters and so avoid the necessity of sending vast sums of money out of the country.

Reply:

Mr Donald:

I tried to make the point in this discussion here that the last ten years in particular have been very much a learning stage both with the professions and the things which are developing and the results which insurers have had, have hardly really shown that they are making a fortune. If they really extracted the figures as they wanted to and not as I wanted to, they could prove hefty losses. We cannot see the results in any one year except 1966. It is this run off of claims and lack of knowledge in liability insurance that causes problems.

If you take part in a world wide pool there is a chance that there is a capacity for the whole market to absorb a skyrocketing claim. Whether we could do this in N.Z. without the volume of premium I do not know.

If for example solicitors and accountants were paying $500,000 it is possible we could well see that extinguished in a series of $80,000 claims some of which are not estimated as $80,000. They are put down as "no estimate" because the underwriter does not know. There is a case where for 3 years it was a claim with nothing against it and now it is fixed alive at $20,000. I feel there is a history of experience that underwriters can offer and also a capacity to absorb any large claims.

We are able to share some of the primary losses and it is going to come down really to the risk control that is brought into it and also the definition of N.Z. experience. The series of claims we know of and other brokers have got is producing information that will give a history and give us something to work on. If there is an easier area to define liability the insurance market is to be used to take out the humps and hollows.

Question:

Mr Morgan:

Asked:-

(a) Is this the least profitable insurance underwriters are asked to accept?

(b) What is a reasonable profit underwriters would expect from Professional Liability Insurance?

(c) Are there statistics to show a captive market of professional men?

(d) Do increased premiums show a marked drop in the number of policies being taken out or renewed?

Reply:

Mr Donald:

After the major changes certainly there was a reduction in the number of firms that insured but, equally, there was virtually a revitalised interest in it and we found that while a number of firms were prepared to carry their own risk (at least for about a year) a number of new people came in and some of the old ones are coming back. That is the result of the premium. Buyer resistance is very strong but faced with facts which I hope we will be able to give here, a more realistic appreciation of the problem is existing.

As far as the profitability of insurance companies is concerned I do not think they know how much they expect or hope to make out of it. Certainly they normally seek to cover their expenses. They also like to build some reserves and, hopefully, pay their shareholders.

Going back to the cost of the business. Normally speaking underwriters have taken somewhere round 30% as the cost of servicing the business. And then, of course, they seek to have some reserves which they try to take out. So that I think . . . I am trying to cast my mind back briefly . . . one underwriter said if he could make 10% out of it he would be very happy, but he has yet to see it. Most have not been at it long enough to see a true 10% profit in any one year.

I cannot answer part 1. It is certainly highly susceptible to regard as being not profitable, but we do not really know what the final result is.

Question:

Mr Thomas:

Asked whether for the maximum cover the one man practice would receive a reduction in premium.

Reply:

Mr Donald:

I would just like to say that in general the underwriters are measuring the risk on all occasions anyway. It may be that they would provide some facility for insuring part of A as well as B and C.

The public are going to be protected in the whole circle and the professional man could perhaps reduce his proportion and the standard of his own practice could be measured on the premium the underwriters would require.