

Review of section 27(c) of the *Professional Standards Act 2005*

Consultation Paper

October 2014

Background

Professional standards legislation (PSL) was introduced in all states and territories from 2003 to 2005 to address problems of the rising cost and declining availability of professional indemnity insurance. It previously had existed in New South Wales and Western Australia, with schemes in place in New South Wales only.

The nation-wide introduction of PSL was largely as a result of the collapse of HIH in 2001, and the failure of some insurers more generally to appropriately price some classes of insurance and the subsequent rising costs of premiums. These factors made it very difficult for some organisations to obtain public liability insurance and more costly for those in professional occupations to purchase professional indemnity insurance.

The rationale behind the introduction of PSL in each of the jurisdictions was that, by limiting the liability of professionals that belong to a professional association, the maximum level of insurance required is reduced, leading to lower professional indemnity premiums. In return for allowing a limit on liability for economic loss and property damage for members of a professional association, the association is required to demonstrate that it will implement risk management strategies which improve the professional standards of its members, including effective complaints and disciplinary mechanisms. While this is not a statutory requirement, the risk management strategies of the occupational association will be considered during the approval process of a scheme. The caps on liability are required to be reasonable and they vary depending on the professional association and size of the firm in question.

One objective of PSL was to limit future increases in professional indemnity insurance premiums by improving standards of professionals which would lead to reduced claims on insurers.

Under each jurisdiction's legislation, professional associations can submit a proposed scheme for approval to the Professional Standards Council. Each jurisdiction has its own legislation and separate Council, however by agreement with all states and territories, the appointed members of each Council are the same in every jurisdiction.

No other country has legislation equivalent to Australia's PSL.

As set out below, Tasmania's *Professional Standards Act 2005* is different from the PSL in mainland jurisdictions in one key area and, it is claimed, this has resulted in only one PSL scheme being approved in Tasmania. Following concerns raised from some professional associations, the Government has decided to undertake a review of the relevant provision. The review is confined to this single provision in the Act.

The review is being conducted by the Departments of Treasury and Finance, and Justice. Professional associations and bodies, the Professional Standards Council, insurers, consumer groups and other bodies are encouraged to provide submissions to the review. A summary of the review's final report will be publicly released.

Current Tasmanian approach

In Tasmania, the relevant legislation is the *Professional Standards Act 2005*. Tasmania's legislation largely follows the approach adopted in other jurisdictions with one key exception. In Tasmania, under section 27(c) of the Act, a scheme must provide that the professional association is to agree to increase the cap on liability for a scheme member on application by that member in a particular case. That increased cap does not apply to any other members of the scheme or to that member other than for the particular case, or contract, for which the higher cap is required.

Large projects or business ventures require the use of professional services and significant losses may result if professionals with roles in relation to these activities breach a duty of care and are negligent. In capping a professional's liability at a set rate, the risk of economic loss to the client above that level, as a result of a breach of duty of care by the professional, is transferred from the professional to the client.

Clients could seek to take out their own insurance (if it is available) to cover the difference, but would likely pay more than the professional as they have less ability to manage the risk. Alternatively, clients could choose to contract only with professionals who are not members of a scheme and are therefore free to take out insurance at the required level.

Consideration of the issue was given prior to the introduction of the Professional Standards Act in Tasmania. As Tasmania was one of the last jurisdictions to introduce PSL, the Government at the time had the benefit of reviewing the legislation in other jurisdictions and the content and operation of some schemes. At the time, it was considered that the allocation of liability in large contracts should be a matter to be agreed on a commercial basis between two contracting parties and that there was not a sufficiently strong public interest case for legislation to intervene.

Legislation in other states provides the professional association that developed a scheme with the discretion whether or not to approve a higher limit of liability on application by a scheme member. The scheme does not set out criteria for the exercise of this discretion or provide for an avenue of appeal by the scheme member against an unfavourable decision. If the association does not approve a higher limit of liability and the scheme member wishes to enter into the contract, the member would have to opt out of the scheme if the member intends to accept the contract.

The Departments of Treasury and Finance, and Justice, are not aware of any cases where a member in a scheme in another jurisdiction has applied to the association to increase the cap that applies to that member.

The Tasmanian approach has the advantage of keeping professionals as members of a scheme and therefore subject to the standards, continuing education programs and disciplinary mechanisms provided in the scheme, while enabling businesses in Tasmania to seek contracts for large projects.

However, as set out below, the result has been that many professional associations have chosen to not submit a scheme to apply in Tasmania. Some professional associations have stated that the inclusion of 27(c) has made the Professional Standards Act unworkable. Concerns have been raised by a number of professional bodies that by allowing two parties to negotiate their own liability cap, a scheme approved under the Act would not achieve the overarching objective of the legislation to limit the civil liability of professionals and protect consumers through improved and monitored professional standards.

It has also been claimed that the lack of control by the professional associations on the cap on liability and the likelihood of higher insurance premiums are key reasons why associations have elected to not submit schemes to the Council in Tasmania.

According to some associations, the effect of submitting a compliant scheme in Tasmania is that they will face higher insurance premiums and will face an unknown level of liability. However, as their members in Tasmania are not in a scheme, they currently have no cap on their liability for economic loss and they are likely to bear this in mind in choosing the level of insurance they take out with their insurers.

One association has advised that the cost of preparing a scheme for Tasmania and providing the accompanying documentation including actuarial advice, can be around \$500 000. The legislation in mainland jurisdictions has mechanisms that allows schemes approved by the Council in one jurisdiction to be approved in other jurisdictions. This significantly reduces the costs to members of submitting schemes for Council approval as one scheme can effectively apply to several jurisdictions.

These arrangements cannot apply to Tasmania due to the operation of 27(c), as any mainland scheme would be non-compliant with Tasmania's legislation. It therefore becomes more costly, on a per member basis, to prepare a scheme for submission in Tasmania as the joint approval arrangements cannot currently apply. It is not known whether Tasmania's Act could be amended to overcome this obstacle.

Current schemes

There are currently 19 professional organisations with schemes in operation, most of which operate in all Australian jurisdictions except Tasmania. Approximately 65 000 persons in professional occupations are covered by a scheme.

The professional associations that have current schemes approved are the following:

- Association of Taxation and Management Accountants (ATMA): 2013–17
- Australian Computer Society (ACS): 2010–14
- Australian Property Institute Valuers Limited (APIV): 2010–15
- Bar Association of Queensland: 2013–18
- College of Investigative and Remedial Consulting Engineers of Australia (CIRCEA): 2013–18
- CPA Australia: 2013–16
- Engineers Australia: 2009–14 (SA, TAS); 2010–15 (ACT, NT, QLD, NSW, VIC)
- Institute of Chartered Accountants Australia (ICAA): 2013–14
- Institute of Public Accountants (IPA): 2013–17
- Law Institute of Victoria: 2010–15
- Law Society of NSW: 2012–17
- Law Society of South Australia: 2010–15
- Law Society of Western Australia: 2014–19

- New South Wales Bar Association (NSW Bar): 2010–15
- Professional Surveyors Occupational Association (PSOA): 2013–18
- Queensland Law Society: 2010–15
- South Australian Bar Association (SA Bar): 2012–16
- Victorian Bar Association: 2014–19
- Western Australian Bar Association (WABA): 2014–19

There is only one scheme in force in Tasmania, the *Engineers Australia* scheme. The scheme sets a cap on the liability of its members but, to ensure compliance with Tasmania's legislation, the scheme specifically states that Engineers Australia must approve a higher maximum liability than would otherwise apply under the scheme as required under section 27 (c).

Professional indemnity insurance costs

The Australian Prudential Regulation Authority has been monitoring insurance premiums since 2003, through the National Claims and Policies Database.

The average written premium for professional indemnity insurance in Tasmania has fallen over the past decade by an average of \$2 011 (or 64 per cent) from \$3 164 in 2003 to \$1 153 in 2013. The average decrease nationally over the same period was greater at \$2 418, from \$4 610 to \$2 192, but this represented a proportionately smaller decline of 52 per cent.

The average premium for professional indemnity insurance is lowest in Tasmania, followed by the Northern Territory (\$1 557), Queensland and the Australian Capital Territory (both \$1 717). The highest average premium for professional indemnity insurance in 2013 was in New South Wales (\$2 789); this is likely to reflect the greater number of high value contracts that are entered into by professional service firms in that jurisdiction.

As very few professionals are in a PSL scheme in Tasmania, it might have been expected that professionals would tend to take out insurance for a greater amount, and therefore pay higher premiums than for equivalent professionals in mainland jurisdictions. Equally, if professional associations in Tasmania, and members of those associations, have not been required to undertake measures to raise professional standards, it might have been expected that the claims experience in Tasmania would have resulted in premiums falling by a smaller percentage than in jurisdictions with many members in schemes. By contrast, average premiums fell by a greater share in Tasmania.

It is therefore unclear to what extent membership of PSL schemes affects the amount of professional indemnity insurance that professionals choose to take out, or on the premiums charged by insurers.

Consultation Process

The review is considering whether it is in the public interest, taking into account the interests of professionals, clients and the community more generally, to either retain or remove section 27(c) of the Professional Standards Act. The review team, comprising officers in the Departments of Treasury and Finance, and Justice, will focus on evidence provided by submissions to guide its deliberations.

The review team is particularly interested in responses to the following questions:

- Why have several professional associations chosen to forgo the benefits to members of establishing PSL schemes in Tasmania due to the operation of section 27(c)?
- Have professionals been required to take out more professional indemnity insurance in Tasmania, compared to equivalent professionals in mainland jurisdictions who are in PSL schemes?
- Are professional indemnity insurance premiums higher in Tasmania, compared to premiums for equivalent insurance for professionals in mainland jurisdictions who are in PSL schemes, as a result of professionals in Tasmania not being in a PSL scheme?
- Have there been any instances in other jurisdictions where members of schemes have requested their association to contract above cap limits, and if so, what have been the outcomes and consequential effects on scheme viability?
- In the absence of schemes for some professions in Tasmania, such as accountants and lawyers, is there any evidence of disadvantage or harm to those professionals, such as unreasonable requests for higher levels of insurance by clients or potential clients?
- Is there any evidence that the risk allocation is inequitable for small or large contracts between professionals and clients in Tasmania as a result of the absence of schemes for professionals such as accountants and lawyers?
- Is there any evidence that professional standards in Tasmania are lower than in other jurisdictions, as a result of professionals in Tasmania not being members of a PSL scheme?

Detailed case studies and supporting data are requested. The review team acknowledges that some information may be commercial-in-confidence and as a result submissions will not be made public.

The review team will also hold meetings with stakeholders over the November – December 2014 period.

The review team expects that the final report to the Government will not be publicly released as it may contain commercial-in-confidence information. A summary of the final report will be publicly released.

The closing date for feedback is **5pm, Friday 13 February 2015**.

Submissions should be forwarded to Ms Colleen Johnstone, Department of Justice:

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