Dr Sarah Bachelard
Secretary
Senate Economics Legislation Committee
Parliament House
CANBERRA ACT 2600

Dear Dr Bachelard

**Supplementary Submission to the Senate Economics Legislation Committee
Inquiry into the Treasury Legislation Amendment
(Professional Standards) Bill 2003**

Having reviewed the submissions made to the present inquiry into the Treasury Legislation Amendment (Professional Standards) Bill 2003 and in light of evidence given to the Senate Economics Legislation Committee by various parties, Professions Australia wishes to make a supplementary submission to the Committee.

An Executive Summary of our supplementary submission is attached to this letter. We have provided numerous sub-headings in the summary and the submission to guide the Committee to our discussion of some of the key points raised in other submissions and at the Committee hearing. Where necessary, we have repeated some points from our original submission to provide context.

Yours sincerely

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Executive Summary

The Need for Professional Standards Legislation (PSL) with Limitation of Liability

The Treasury Legislation Amendment (Professional Standards) Bill 2003 does not introduce PSL. However, without it, PSL initiatives introduced by State and Territory governments will be ineffective, as plaintiffs will be able to use provisions in federal law to by-pass liability caps established under PSL.

Federal, State and Territory insurance ministers of all parties support professional standards legislation (PSL) because they accept that there is market failure in professional indemnity (PI) insurance, meaning the market has not been able to provide adequate, affordable insurance to cover the full range of services provided by professionals.

Ministers have accepted that nationally consistent PSL, together with proportionate liability, changes to section 54 of the Insurance Contracts Act and changes to relevant Commonwealth legislation to give effect to State and Territory PSL initiatives will make PI insurance more affordable and available by attracting capital back into the PI insurance market and will better protect consumers of professional services.

PSL is in the broader public interest. As PSL requires professionals to be insured or have assets to the level of their liability ceiling, and because PSL will encourage insurers back into the PI market, the result will be that resources will be available to compensate successful plaintiffs, meaning actual recovery of damages by plaintiffs is likely to be higher under a system of PSL than without it. Liability ceilings would also be set at a limit where all consumer claims and the vast majority of commercial claims would be met in full.

Contracting Out

Permitting "contracting out" of PSL schemes will undermine the public policy objectives that insurance ministers seek to achieve through PSL.

"Contracting out" of PSL schemes has been prohibited under all existing Professional Standards Acts and Bills and continues to be emphatically opposed by professional groups, the Professional Standards Council and the Insurance Council of Australia for the reason that it would make PSL unworkable and would destroy the schemes established under it.

PSL's policy objectives are best achieved by ensuring broad coverage and comprehensive application of PSL schemes. Allowing contracting out will result in the opposite. Ideally schemes should be compulsory for members of occupational associations who are intended to be covered by those schemes.

Rather than contracting out being a "voluntary act" by professionals, it would be forced upon professionals by larger corporate clients who would use their market power to ensure that professional firms carry corporate risk via the professional's PI insurance.

The pressure to permit contracting out is an attempt to transfer entrepreneurial risk in the corporate sector and public sector risk in the government sector to professionals via PI insurance. If this succeeds it will mean PI insurance will continue to be less available and affordable.

Assignments that require higher liability to attach to professional advisers can be accommodated by ensuring that schemes are structured to meet the generalised needs of clients and professional firms of different sizes. Each scheme does and would allow for different levels of caps, including the possibility of allowing firms the flexibility to select higher liability caps to apply for all assignments. This answers the criticism made by some that caps are inflexible and do not allow firms to "compete" on the basis of their liability exposure.

Risk Shifting

Rather than PSL representing a shift in risk away from professionals, PSL is about the appropriate allocation of the burden of risk, as correctly identified by Treasury officers in evidence to the Committee.

Just as with public liability, there is an urgent need to rein-in community expectations as to the level of damages that can be paid because insurance cannot operate to spread the quantum of risk that now exists.

Risk has progressively been shifted onto professionals over the past two decades, with professionals' liability exposure increasing dramatically over this period.

Moral Hazard and Immunity from Failure

Professionals accept that liability caps ought to be set at levels that provide sufficient incentives for professionals to ensure they carry out their tasks with due care and diligence. There is a point beyond which, however, the marginal effect of an additional financial penalty on a professional's incentive to perform his or her job well will be zero.

Further, if liability remains unlimited, or if the liability risk is perceived to be disproportionate to the gains to be made from providing the service, then professionals will continue to respond in other ways, namely by withdrawing from the provision of high risk services, or by structuring to minimise their available assets.

Firms with a poor record of risk management and adverse claims records will not be immune from failure. Such firms will face increasing difficulty in obtaining insurance cover at affordable levels as well as face the market consequences of diminished reputation, either of which could result in failure for a firm.

PSL will mean that in the event of the failure of such a firm, clients will be protected by the requirement for that firm to carry PI insurance to the level of the applicable cap.

The Impact of PSL on PI Insurance

A national system of PSL, by providing safety ceilings on claims and mandating risk management schemes and other consumer protections, will have a significant beneficial impact on insurance as insurers will know the ceiling for which claims can be made. This will allow them to cost their risk with certainty. Such certainty will encourage insurers back into the market, thereby increasing competition and resulting in cost reductions through market forces driving down premiums.

Whilst evidence was given that it is the weight of small claims that predominantly drive PI insurance supply and cost, the significance of large claims must not be discounted. Insurers seek to avoid volatility in an insurance book and introducing liability ceilings for professional indemnity will result in more predictable outcomes for insurers.

Large payments of damages are rare but nevertheless their possibility has a serious impact on PI insurance profitability and hence the preparedness of insurers to underwrite risk, as is the case in public liability insurance.

Flexibility

Schemes can be designed in a way that permits flexibility in the caps that apply. The Solicitors' Scheme in NSW is designed so that the maximum cap, which is matched to compulsory PI insurance, increases on a sliding scale in line with the size of the firm. However, any firm of any size can elect to have a higher cap, up to an overall ceiling of $50 million, enabling firms to compete on an equal basis where liability limits are an issue of concern to clients.

For the most part, firms of similar size and structure offering similar services will work on similar risk/reward ratios and have similar capacity to access and afford PI insurance. Their ability or willingness to compete on the basis of their maximum liability will not differ greatly.

Why are Incentives Needed for Professionals to Adopt Best Practice Risk Management?

PSL, by linking risk management to ceilings on liability limits, not only provides real incentives for professionals to implement risk management and adhere to professional requirements, it provides professional associations with significant leverage to impose high standards on members.

Risk management programs run by associations are costly to run and the cost is borne by members. Members can more readily accept such costs when they are part of a package that includes liability ceilings, as is the case under PSL.

Risk management under PSL has the following further advantages:
- Independent review and assessment of risk management practices;
- Greater accountability on the part of professional bodies and occupational groups for the risk management processes they impose; and
- Greater transparency of risk management programs.

Size of Caps and Scheme Approval Processes

Caps are proposed by professional associations. The Professional Standards Council (PSC), a statutory body established under PSL, evaluates, analyses and assesses (not "consents to") the proposal in line with supporting information on claims data and history and insurance availability and cost. The review process specifically considers the likely impact of schemes on consumers. After a review process that takes at least seven months or longer, and after public submissions are considered, the PSC will make a recommendation to the relevant government Minister on whether a scheme, including the capping proposal, should be approved. Approval then rests with the Minister. Neither the PSC, nor the Minister, simply "consents" to caps proposed by professional associations.

Associations must provide information that is as comprehensive as possible on the cost and availability of PI insurance and on the claims experience of the profession to the PSC in its application for a scheme. Caps are therefore struck by reference to the level of affordable insurance cover obtainable by the profession.

Sunset Clauses on Schemes

Existing PSL sets sunset clauses on schemes that are appropriate given the need for predictability and certainty in the insurance market, the nature of claims made against professionals, the length of time in which actions may be brought, and the nature of the market for PI insurance. Further, should there be any change in circumstances that warrants review of the scheme's continuing relevance, mechanisms exist for such review and possible revocation if required.

Commencement of Schemes

Any concern that PSL will operate to limit liability for causes of action that pre-date PSL is unfounded. PSL will only operate in respect of a cause of action founded on an act or omission occurring during the period when a scheme is in force. Professionals further are required under PSL to provide notice to their clients that their liability is limited.

Involvement of Other Regulatory Bodies in Scheme Approval

Adding additional layers of regulatory approval would be wasteful and time consuming, as the ACCC and other regulatory agencies will have an opportunity to comment on schemes as part of the consultation process built into the scheme approval process.

Discussion Re: CLERP Commentary on PSL

Little weight should be given to the objections to PSL contained in the CLERP 9 discussion paper, which are either redundant or flawed due to their failure to address insurance issues. As its main source of authority, CLERP 9 cites negative comments on the effect of PSL contained in a *1993* report by the MINCO Working Party looking at professional liability issues under the Corporations Law.

ACCC Evidence on PSL

Professions would submit that the arguments put to the Committee in evidence by the ACCC fail to take proper account of cost and availability issues regarding PI insurance. The Committee should also note a different view on the public record from the ACCC Chairman.