

Stop Loss

A Publication of LawCover
also available at
www.lawcover.com.au

December 2004
PP241082/00014

**LAWCOVER
HAS MOVED TO**
Level 12
580 George Street
Sydney NSW 2000
Our DX address,
phone & fax numbers
remain the same



2005/2006 COMPULSORY PII RENEWAL TIMETABLE

Under Section 41 of the *Legal Profession Act 1987*, an insurable NSW solicitor must have appropriate Compulsory Professional Indemnity Insurance (PII) in place prior to the Law Society issuing their practicing certificate.

LawCover's 2005/2006 renewal of Compulsory PII commences in January 2005 with the distribution of the Premium Rating Information Form.

As in previous years, the form will require certain information about your firm, including Gross Fee Income (GFI) figures for the years ended June 2004 (actual), June 2005 (estimate) and June 2006 (estimate). LawCover understands that many firms close their doors over the Christmas period. Accordingly, you may wish to consult your accountant now to ensure you have your GFI information available to assist timely completion and return of the form.



*by Matthew Gosling,
General Manager,
Insurance & Business
Development*

| ACTIVITY | BY WHOM | DUE DATE |
|---|---|----------------|
| PII Premium Rating Information Forms sent to all active NSW firms | LawCover | Early Jan 2005 |
| Completed PII Premium Rating Information Forms returned to LawCover | NSW Firms | Mid Feb 2005 |
| Finalise scheme negotiations with reinsurers | LawCover | February 2005 |
| Approval of reinsurance arrangements for 2005/2006 | Attorney-General Law Society Council LawCover Board | Mid March 2005 |
| Calculation of individual firm premiums | LawCover Actuaries | March 2005 |
| PII Application/Renewal Forms sent to all active NSW firms | LawCover | Mid April 2005 |
| Completed PII Application/Renewal Forms returned to LawCover with payment | NSW Firms | Mid May 2005 |
| Deadline for payment of insurance premiums | NSW Firms | Mid May 2005 |
| All insurance arrangements for NSW firms finalised | LawCover | End June 2005 |
| Practising Certificates and Insurance Policies issued | Law Society LawCover | July 2005 |

Your prompt attention to the Premium Rating Information Form and adherence to those parts of the timetable that apply to you will greatly assist LawCover in ensuring the scheme and your firm's Compulsory PII arrangements are completed by 30 June 2005.

LawCover's Underwriting Team is available to assist firms with any queries arising from the Premium Rating Information Form on **1800 650 748**. Information, including Frequently Asked Questions, will also be posted on LawCover's website at www.lawcover.com.au.

In this edition...

| | |
|---|---|
| ● 2005/2006 Compulsory PII Renewal Timetable | 1 |
| ● Outside Directorships | 2 |
| ● Validation of Gross Fee Income Estimates | 2 |
| ● Claims Discounts and Loadings | 3 |
| ● Case Study – The Impact of Claims on Premiums | 3 |
| ● 2004 – A Defining Year for LawCover | 4 |
| ● Have Your Say on Market Research | 4 |

LawCover Pty Ltd
ABN 48 003 326 618
AFSL No: 236051

LawCover Plus Pty Ltd
ABN 87 082 830 751
AFSL No: 236052

LawCover Insurance Pty Ltd
ABN 15 095 082 509

Level 12, 580 George Street
Sydney NSW 2000 Australia
DX 11527 Sydney Downtown
Telephone (02) 9264 8855
Facsimile (02) 9264 8844
www.lawcover.com.au

OUTSIDE DIRECTORSHIPS

Solicitors may take up directorships in companies outside their firm for a variety of reasons. The company may be controlled by a client or a friend. The appointment may present an important strategic advantage for the individual or the firm, which may include increased ability to attract or retain work from the company, and the ability to attract other work through contacts made with fellow directors.

It is important to be aware that LawCover's current Professional Indemnity Insurance (PII) Policy arrangements (at both Compulsory and Top Up level) **do not** provide cover for any claim, against the individual or the firm, that arises from or in consequence of that directorship or activities undertaken as a director. That is, there is no cover for claims against a solicitor who is a director that arise out of being a director, and there is no cover for other partners of a firm in respect of a claim that they are vicariously liable for the actions of another partner or an employee who was a director.

Partners are jointly and severally liable for loss or injury to a third party caused by any wrongful act or omission of any partner or partnership acting in the ordinary course of the business of the firm, or with the authority of the partner's co-partners. However, under section 10(2) of the *Partnership Act 1892* (NSW), a partner acting as a director is not to be taken to be acting in the ordinary course of the business of the firm, or with the authority of that partner's co-partners, only because of any one or more of the following:

- the partner obtained the agreement or authority of the partner's co-partners, or some of them, to be appointed or to act as a director of the body corporate;
- remuneration that the partner receives for acting as a director of the body corporate forms part of the income of the firm; and/or
- any co-partner is also a director of that or any other body corporate.

This provision provides some protection for partners of directors but it is not comprehensive. A firm may still face an allegation that it is vicariously liable for the acts of one of its partners as a director, and may still be found liable.

Some firms may decide to prohibit partners from accepting an appointment as a director or officer in an outside entity. Others may encourage partners not to accept such appointments. Firms who do have partners who hold directorships in outside entities should take steps to mitigate the risk of the firm being sued as a consequence of acts or omissions of the partner who is also a director.

These steps could include the firm:

- obtaining separate insurance to cover vicarious liability claims arising from outside directorships;
- ensuring that the level and scope of Directors & Officers insurance held by the company is adequate;
- ensuring that the proposed appointee has the experience and skills required to properly discharge the duties and responsibilities of a company director;
- checking that the company's financial position and management is satisfactory;
- ensuring that there is a clear delineation between the services provided by the director and the legal services provided by the firm, including a separate written retainer between the company and the firm; and
- putting in place steps to ensure that any person appointed as a director or to a similar position does not undertake legal work for the company or entity and is understood not to be undertaking legal work. If that is not possible, ensuring that legal work undertaken by the partner who is also a director is performed in accordance with a written retainer between that company and the firm to ensure that there is a clear separation of the director's role from the performance of legal work.

VALIDATION OF GROSS FEE INCOME ESTIMATES

The Premium Rating Information Form sent to firms each January gathers information about your firm's risk profile. This includes a request for information as to your firm's actual Gross Fee Income (GFI) for the last financial year, and your forecast estimated GFI for the present and subsequent years.

As LawCover bases premiums on GFI, it is essential that the GFI estimates be as accurate as possible.

LawCover uses a GFI validation process to ensure that firms' GFI estimates are soundly-based. Firms that consistently under-report their GFI are identified by this process.

LawCover may determine, based on prior years' experience, that a firm has under-estimated its GFI. In these cases, LawCover will contact the firm and advise the revised estimated GFI on which LawCover will base their premium.

Validation testing includes:

1. Calculating average GFI per solicitor for the firm and comparing this to:
 - a) the average in the profession; and
 - b) the average GFI per solicitor for firms in the same geographical location (that is, city, suburbs, regional areas);
2. Comparing the firm's estimate of earlier years' GFI to the actual GFI earned in those years to profile firms with substantial variances; and
3. Random audits of firms' estimated GFI by requesting statutory declarations or accountants' certificates from firms at their own cost.

Firms may find it useful to record their method of GFI estimate calculation to assist in the event that LawCover requests information as to how estimates were derived.

CLAIMS DISCOUNTS AND LOADINGS



by Jacqueline Braams,
Principal Underwriter

Solicitors are understandably concerned about how their past claims history can affect their firm's premium. However, many do not understand how premium adjustments in respect of claims are determined.

LawCover offers no-claim or low-claim bonuses of up to 15% to firms that have been in business for the relevant five-year

period and have a good claims record over that time. However, firms that have a poor claims record over the same five-year period will be subject to a claims loading on their premium. Claims loadings can be a significant amount. LawCover offers risk management courses and advice to help reduce a firm's potential for claims.

The case study below gives an example of a firm with poor claims experience that has a substantial claims loading applied to its premium.

CASE STUDY – THE IMPACT OF CLAIMS ON PREMIUMS

Tom is one of two partners at the firm A & B Legal. As the partner responsible for the firm's PII arrangements, Tom has a good understanding of how his firm's premium is calculated – based on firm size, claims adjustment, discounts applied and applicable taxes. However, after reviewing his firm's premium calculation details on the 2004/2005 PII Quotation Form, Tom is concerned about the Claims Adjustment figure, the loss ratio of 183.7275% and the significant impact on the overall premium.

Tom is aware the firm has notified LawCover of a number of claims over the years but was certain that none of these claims had been successful. Tom contacts LawCover's Underwriting Team to discuss his premium.

The LawCover underwriter takes Tom through a step-by-step process of how his firm's claims adjustment figure was reached: A five-year period is used to assess a firm's claims experience and Tom's firm has two claims in the relevant five-year period with total incurred values of \$32,000 and \$275,000. (The total incurred value is a realistic assessment of the total cost to the insurer of the claim to its conclusion.) Total incurred values are capped at \$250,000 for a firm of Tom's size, and the total value of the firm's claims for the relevant period is therefore \$282,000.

In determining a Claims Adjustment figure, the total incurred value is compared with the total premium paid by the firm over the same five-year period, which in A & B Legal's case has been \$129,054. LawCover also calculates a 'notional' five year premium and the higher premium out of the two is used in the comparison. The underwriter notes the firm's notional premium is \$153,488.*

The comparison results in a loss ratio percentage of 184%. That is, the firm's claims are 1.84 times their premiums. This loss ratio is applied to a table of discounts and loadings which specifies

what adjustment, if any, will be made to the firm's base premium as a result of the claims experience. In this case, a firm like Tom's with a loss ratio of 184% and a GFI of \$850,000 will have a loading of 20% applied to the base premium of \$35,452, resulting in a claims loading of \$7,090 and a total premium of \$42,542. Loadings can be higher or lower than this, depending upon the size of the GFI and the size of the loss ratio.

Tom advises the underwriter that none of the claims against his firm have been successful and that, in fact, costs have been awarded in the firm's favour in the large claim. The underwriter explains that defence costs were paid on the firm's behalf and this needs to be taken into account when calculating premiums. Some firms get sued regularly and require extensive defence representation, and it is only fair that their premium reflects this and is higher than for firms that never have any actions initiated against them.

Tom was also told that, should those costs be recovered prior to 1 July, the premium could be reviewed in respect of the loss ratio calculation. However, generally, in LawCover's experience, it is very unusual for costs to be fully recovered. If they are recovered and the loss ratio substantially improves, a future reduction in the loading should result. Premiums are not reduced or increased after 1 July as a result of any future improvement or deterioration of past claims.

Note: The notional premium is calculated to iron out any inconsistencies in the premium rating system as a result of the change from a per solicitor system to a fee rating system in 2002/2003. This is done so that firms who paid less under the per solicitor system than under the current system are not penalised as a result of the changes. The notional premium is effectively what the firm would have paid over the five years had the current rating system been in place during that time.*

| | POSITION |
|---|-------------------------------|
| The Gross Fee Income (GFI) of the firm | \$850,000 |
| A Total premiums paid over five (5) years | \$153,488 |
| B Total claims incurred over five (5) years | \$282,000 |
| Loss ratio (B divided by A) | 183.7275% |
| C Base premium for firm based on its \$850,000 GFI | \$35,452 |
| D Claims loading for poor claims** | (20% of base premium) \$7,090 |
| Total premium net of taxes (C + D) | \$42,542 |

*Note** Firms with lesser Gross Fee Income (GFI) and with a similar loss ratio to the example above would typically have a lower claims loading and firms with greater GFI would typically have a greater claims loading.*

2004 – A DEFINING YEAR FOR LAWCOVER

1 March 2004

By 11 March 2004, anyone who carried on a financial services business (that is, dealing in a financial product or providing financial product advice) had to have an Australian Financial Services (AFS) licence covering the provision of those financial services.

Both LawCover and LawCover Plus required an AFS licence, LawCover because of its role in negotiating the terms of the master policy for Compulsory PII and arranging placement of the insurance with the insurer, and LawCover Plus for its similar role in relation to Top Up Insurance.

LawCover and LawCover Plus both secured AFS licenses on 1 March 2004 to allow them to continue to arrange PII and Top Up cover for the legal profession.

The licences authorise the companies to deal in general insurance products and to provide advice in relation to general insurance products.

2 April 2004

On 1 March 2004, Lloyd's of London strengthened its bylaws for approving Coverholders. A Coverholder is effectively an agent of Lloyd's and is authorised under a binding authority agreement to bind business on behalf of Lloyd's with limited referral.

LawCover Plus applied for Coverholder status on 2 March 2004, and secured this status on 2 April 2004.

13 April 2004

The Australian Prudential Regulation Authority (APRA) granted LawCover Insurance Pty Limited (LawCover Insurance) an insurance licence. This is the first insurance licence granted by APRA to a legal profession-based insurance scheme in Australia.

The establishment of LawCover Insurance is a strategic move away from the previous agency model and is designed to better insulate the legal profession from the capacity and pricing volatility of the international commercial insurance market, which should in turn provide increased stability and affordability.

The company is compliant with APRA's General Insurance Prudential Standards which cover such matters as risk management, reinsurance management, capital adequacy and the valuation of liabilities.

Under its licence conditions, LawCover Insurance can provide PII to legal practitioners where PII is compulsory under a law of any State or Territory of Australia.

10 May 2004

Paul McGahen was appointed CEO of the LawCover group of companies. Prior to joining LawCover, Paul was Chief General Manager, Corporate Services and Company Secretary for Allianz Australia Limited.

He joined Allianz in 1995 and held general management responsibility for a number of insurance product lines including Compulsory Third Party (CTP), workers compensation and commercial insurances.

30 June 2004

Compulsory Professional Indemnity Insurance renewal documentation was issued, processed and completed for over 4,000 firms for the 2004/2005 insurance year, thus ensuring insurance arrangements were in place and allowing the Law Society of New South Wales to issue practising certificates.

21 July 2004

Terry Paradine was appointed chairman of the LawCover group of companies.

Mr Paradine has over 40 years' experience in the insurance industry. From 1966 to 2003, he served in a number of senior management positions with Marsh & McLennan Companies, Inc and its predecessors. Most recently, he was chairman, Asia-Pacific Region, Marsh & McLennan Companies, Inc., where he was responsible for the parent company overview of the group's businesses in 14 countries. Other past senior management positions include chief executive officer for Marsh in UK, and chairman and chief executive of Marsh in Australia.

1 December 2004

In addition to the renewal of insurance arrangements for more than 4000 firms, LawCover has since provided over 600 new firms with Compulsory Professional Indemnity Insurance.

HAVE YOUR SAY ON MARKET RESEARCH

LawCover is committed to consultation with solicitors to ensure that our insurance arrangements are best suited to the needs of our customers. With this in mind, we are currently undertaking a market research program to investigate solicitors' views on possible changes to the method of determining premiums for the 2005/2006 insurance year and beyond.

If you would like your views to be included, please visit the "Important News" section of the LawCover website at www.lawcover.com.au to download a questionnaire.

The aims of the market research are to:

- assess the strengths and weaknesses of the current premium rating model;
- assess the strengths and weaknesses of our communication of the premium rating model; and
- explore the profession's premium rating system requirements for 2005/2006 and beyond.

The results of the market research will be published in future editions of *Stop Loss*.