Expert Report concerning Solicitors' Professional Indemnity Insurance in NSW

Department of Communities and Justice

October 2024

Contents

Executive summary

Solicitors in NSW are required to hold or be covered by a professional indemnity insurance (PII) policy in order to obtain a practising certificate from the Law Society of NSW. At present, only one provider, Lawcover (owned by the Law Society of NSW), is approved by the NSW Attorney General to provide mandatory PII, although some law firms operating across jurisdictions can obtain PII from other jurisdictions.

The Proponent Insurer, a consortium of ABC Insurance (ABC) and Liberty Specialty Markets (Liberty), has proposed providing a PII Policy for solicitors practicing in NSW; that is, as a market competitor to the current Lawcover policy. The consortium has submitted its policy for consideration by the NSW Attorney General.

In response, the NSW Department of Communities and Justice (the Department) has commissioned this report as an actuarial assessment to assist it in providing advice to the Attorney General. Specifically, it provides an actuarial assessment of the potential impact of ABC's entry on the market, an evaluation of the current market, and an analysis the potential short- and long-term implications of approving one or more new PII policies for solicitors operating in NSW.

The Department is interested in understanding how approving one or more policies may affect the stability of the market, the availability, affordability, and accessibility of PII, and the adequacy of cover. It is also interested as to whether any change could raise the potential for NSW solicitors to become unable to obtain insurance at an appropriate and reasonable price, and the impact of this on the protection of clients of NSW Solicitors.

The analysis contained within is supported by a number of key data sources. These include data and information from the Australian Prudential Regulation Authority (APRA), and the Victoria Legal Practitioners' Liability Committee (LPLC). Further to this, Lawcover have provided responses to a set of clarification questions as well as a number of reports, while Deloitte was also provided with a number of reports completed by Finity, Lawcover's appointed actuary. These Finity reports have been used as evidence to inform this report, but the analysis has not been independently verified by Deloitte. In addition to this, further evidence has been collated across previously commissioned reports investigating the NSW solicitors' PII market (primarily Taylor Fry's previous market review), publicly available data, and academic research.

Assessment of ABC

Liberty is well placed to act as the insurer in providing this policy and has sufficient capital to support the business. Deloitte has not been tasked to directly assess ABC's capabilities with respect to underwriting, claims management, and other required insurance functions. Similarly, Deloitte has not reviewed Lawcover's insurance functions.

Evaluation of the current market

The current market for solicitors' PII in NSW was assessed in terms of market stability, affordability, premium stability, accessibility, market coverage, and consistency with other jurisdictions. Overall, the evidence suggests that the current market is performing well across many of these objectives.

Under Lawcover, there has been a high level of market and price stability along with market coverage and accessibility. There is no evidence that law firms are currently facing challenges in obtaining solicitors' PII. In terms of affordability, the comparison between premiums and claims in NSW shows that premiums per solicitor are currently higher than in Victoria but broadly similar to Queensland. This is partly due to relatively higher claims per solicitor in NSW. However, some of the difference in premiums does appear to reflect the greater administrative efficiency of LPLC, the professional indemnity insurer in Victoria. LPLC also operated at a greater loss (or combined loss ratio) in 2023 than Lawcover and Lexon in Queensland. However, it is also notable that premiums in NSW as a share of gross fee income are substantially lower than in certain overseas markets, with the England and Wales solicitors' PII market used as a comparator.

Deloitte does not have the level of granular information to consider the level of premium by location or by area of practice. However, Deloitte notes that, at an overall level, Lawcover is able to provide accessible cover for solicitors.

In terms of comparability, mandatory PII is provided by Lawcover in ACT and NT, and similar bodies in all states other than Victoria, where a statutory body provides PII. In terms of risk management, while there is no clear evidence of declining claim frequencies over the last decade, detailed analysis by Finity shows a return on investment from some of Lawcover's risk management activities.

Impact of competition

Economic theory would suggest that greater competition in the market for solicitors' PII would lead to lower premiums and better quality services. A previous NSW Attorney General's Department Review in 1999 recommended that the market be deregulated, subject to certain conditions and a maximum of three players, with solicitors in NSW able to choose their insurer. Notwithstanding this, there are several aspects of the market for solicitors' PII that make it distinctive from a standard market: the product is designed to protect solicitors' customers, it is mandated, it can work as a form of regulation (but may do this best when provided by a professional body), and that it generates data which may assist with risk management programs.

Other solicitors' PII markets in Australia also have single-provider arrangements, namely through Lawcover itself, similar bodies, master policy agreements with insurers, or a statutory body in the case of Victoria. The solicitors' PII market in England and Wales is a multi-provider market, and has higher, more volatile premiums than those found in NSW, while there are also reports of solicitors struggling to get insurance.

Other PII markets in Australia e.g. engineers, medical practitioners, accountants and barristers tend to allow choice of provider. This provides some evidence that competition can be effective, but drawing a definitive conclusion is complicated given the respective nuances of each market.

Scenario Analysis

To understand the potential impacts of the Attorney General approving one or more new policies, Deloitte was asked to examine the anticipated effects under different scenarios including:

- (Scenario 1) the current state where the AG does not approve the proposed PII policy;
- (Scenario 2) the AG approves the proposed PII policy from ABC; and
- (Scenario 3) the AG approves additional policies.

The analysis explores two variants of scenario 2 in addition to scenario 3, with each explained in more detail below. The scenario analysis does not seek to perfectly predict future outcomes, which are inherently uncertain and will depend in part on strategic choices made by market participants. Any analysis is also limited by the absence of unit level firm premium data. Recognising these limitations, the scenario analysis seeks to describe possible outcomes that could arise informed by: data, both publicly available and from various other sources including Lawcover, other insurers, and the Department; our understanding of insurance market dynamics and actuarial best practice, analysis of comparable markets; and economic theory.

Scenario 2A: This scenario is characterised by a single new market entrant, the proponent insurer, entering into direct competition with Lawcover under a two-provider market structure. The proponent insurer, ABC, actively focuses on marketing itself to firms in less risky areas of practise (e.g. areas other than conveyancing), or at least to those firms which ABC believes to be lower risk relative to the premiums they pay. In order to entice targeted solicitor firms to switch provider, ABC offers a discount on Lawcover premiums.

It is not suggested that ABC would not provide insurance to firms operating in higher risk practice areas (ABC has indicated it will offer insurance to all firms) but rather that its marketing and pricing strategy would seek to focus on firms who act predominantly in lower risk practise areas. Importantly, information asymmetries mean that ABC is unlikely to have perfect information on the risk management processes of potential clients. Therefore, even if ABC targets what it perceives as lower risk market segments, it is unlikely to do so perfectly.

Scenario 2B: Under this scenario there is again a single new market entrant, the proponent insurer, with ABC and Lawcover entering into direct competition under a two-provider structure. However, here ABC does not directly target market segments, and instead aims to maximise market share across all market segments. ABC's marketing and pricing strategies operate agnostic of risk-based characteristics, with the expectation that ABC will aim to undercut Lawcover prices for all firms operating in the market. This means that the expected claims experience of ABC does not materially differ from that of Lawcover.

Scenario 3: This scenario considers multiple new entrants to the solicitors' PII market, with the market functioning as an open market and firms actively competing for market share. Under these conditions, market entrants are unable to implement net risk targeting, meaning that new entrants are not able to select lower risks. Instead, all new entrants aim to undercut Lawcover prices for all solicitor firms operating in the market. Additionally, new entrants may not be well placed to assess which law firms are lower risk.

The outcomes of each of the scenarios are summarised in brief in the table below:

Table i: Scenario outcomes by assessment criteria.

	Premium Stability	Affordability	Accessibility, market coverage, and stability	Risk management	Consumers	Run-off cover
Scenario 2a	Minimal variance in aggregate premiums, with risks of increased premium variability more prevalent for higher risk firms.	Changes in premiums are marginal, with decreases in the short term and an estimated increase in the long term of up to 4%.	Market coverage is likely to be preserved but there may be some small adverse effects if high risk firms struggle to obtain insurance at a reasonable price.	Risk of decreased investment in risk management partially mitigated by demonstrated success of programmes.	Short and long term changes in premiums may be passed on to consumers, but impacts are minimal.	Likely that sufficient coverage will be provided, as [redacted].
Scenario 2b	Impacts similar to Scenario 2A.	Positive short-term impacts to affordability but long-term premiums estimated to increase by approximately 6% for ABC customers. This suggests there may be challenges to ABC's competitiveness in long run.	Risk of market disruption if ABC exits the market, however Lawcover should continue to provide full, accessible coverage.	Impacts similar to Scenario 2A.	Impacts similar to Scenario 2A, however there may be additional disruption to consumers if ABC exits the market.	Impacts similar to Scenario 2A.
Scenario 3	Negative impacts to premium stability as commercial insurance business more likely to allow premiums to vary in line with economic or insurance market conditions.	Positive short-term impacts to affordability compromised in the long term by estimated premium increases of up to 12%.	Significant risk of market disruption as participants enter and exit the market, with follow on impacts to coverage and accessibility.	Lower incentives to invest in risk management, with difficulties in maintaining the quality of risk management programmes anticipated.	Long term increases in premiums likely passed on to consumers; premiums likely to be more variable and insurers are more likely to exit the market with little notice.	As any approved policies will need to meet the requirements of the Uniform Law, it is likely that sufficient run off cover will be available.

Structures to mitigate potential risks

Should the Attorney General choose to approve two or more new insurers to provide mandatory PII to NSW solicitors, certain structures could be developed to minimise potential risks to market stability, premium stability, affordability and accessibility and market coverage.

While it is beyond the scope of this report to undertake a detailed evaluation of potential risk mitigation structures, there are a number of policy options the Department may wish to consider, some of which were canvassed in the 1998 review of the Legal Profession Act including:

- Ensuring that once a policy has been assessed as meeting the requirements of the Uniform Law, insurers are not permitted to make further changes to the policy without consulting the Attorney General to ensure that coverage is not reduced or diminished over time.
- Setting a price cap on premiums to ensure that affordability is preserved, especially for smaller firms. This option was contemplated in the 1999 Review, expressed as a maximum differential between lower and higher premiums. Deloitte note that without a requirement to

provide insurance, price regulation could result in providers not offering insurance to certain firms.

- Asking insurers to take on an 'assigned risk pool', as outlined in the 1999 Review, requiring insurers to take on a certain number of higher cost practitioners. Note, this would not necessarily be required under either scenario 2B or scenario 3 where insurers take on a similar profile of risks.
- Introduction of a risk management activity levy whereby a percentage of premiums paid would go to the Law Society for risk management activities and they would be 'required to account for the funds in the annual reports.' This should only be pursued if there is insufficient evidence of such activities being undertaken by the market.[1]
- Introduction of a market regulator with national oversight. This body would have the power to require providers to regularly submit data, and would then be equipped to evaluate consistency in provider performance relative to these criteria across states, providing a degree of accountability for individual providers.
- Loosening the requirements for solicitor firms to acquire coverage from providers based in their home state. This is more of a complementary policy option than a vehicle to mitigate risk factors, but it is an option the Department could consider to increase the number of competitors in the market. This policy has not been evaluated in this report and would need to be carefully assessed to understand any potential adverse consequences for the market.

These options would require more careful evaluation and consideration before being implemented should the Attorney General decide to approve more PII policies.

Conclusions

The **current market** for NSW solicitors' PII is working relatively effectively when assessed against the Department's criteria. Premiums are affordable, stable, accessible, and comparable with other jurisdictions. Risk mitigation activities undertaken by Lawcover appear relatively effective. A strong PII market supports the work that NSW solicitors undertake in providing services to the people of NSW. Deloitte found evidence that administrative costs for Lawcover were higher than the LPLC in Victoria.

There are potential **benefits** of introducing a competitor to the NSW solicitors' market for PII. There is potential for lower premiums, especially in the short term as providers compete for market share, and for lower-risk firms, as providers match premiums as close as possible to risk ratings. A competitive market would bring NSW solicitors' PII into alignment with other professions like barristers, engineers, accountants and medical professionals. The scenario analysis in this paper finds that average premiums are likely to increase in the longer term, but the magnitudes are small, so they are unlikely to lead to significant affordability or accessibility issues.

There are a number of policy **structures** the government could investigate to reduce risks associated with a competitive market, including hypothecating a share of insurer revenue to risk management activities, approving terms and conditions (especially the provision of adequate run-off cover), and limiting the number of providers in the short term to assess the market impacts. Approving one or more new policies would be consistent with the recommendations from the 1999 Inquiry and the ACCC's advice at the time that competition in the market would improve outcomes.

[redacted] ABC and Liberty are considered appropriate entities for the functions they will undertake in the operating as a consortium in providing this PII policy. Deloitte note we have not seen the agency agreement between ABC and Liberty.

There are, however, a number of **risks** associated with introducing competition. No solicitor's PII market in Australia is competitive, so Deloitte relied on secondary evidence to understand the

1 Attorney General's Department 1998, National Competition Policy Review of the Legal Profession Act 1987: Final Report, http://www.lawlink.nsw.gov.au/report%5Clpd_reports.nsf/pages/ncpf_toc.

potential impacts (the ACT experience with competition, while initially positive, was undermined by the sudden exit of a private provider - backed by Liberty - from that market). The scenario analysis in this report finds that solicitors would likely face higher premiums with the introduction of competition, but as noted above, the magnitudes are likely to be small. What could be of greater concern is the potential for greater volatility in premiums as the market moves through the insurance cycle. Deloitte note the chance that risk management activities could be scaled back, but as noted above, this could be mitigated through government policy. In the long term, there is a chance that insurers avoid solicitors in higher risk areas of practice; again, there could be policy mitigants for that.

The benefits and risks of **multiple competitors** is a more pronounced version of the findings above. As more firms compete for market share, premiums could be lower still in the shorter term but higher in the longer term. The risks of solicitors not accessing insurance and insurers scaling back risk mitigation activities would increase. Overseas, multiple-provider markets have higher premiums, less stable premiums, and issues with solicitors having adequate access to insurance. The potential for insurers to enter and exit the market, causing disruption, is also higher.

Overall, this report provides information to help the Department advise the Attorney General about the impacts of approving one or more policies. In summarising, Deloitte note uncertainty about different outcomes and that some objectives might have different weightings to others. Deloitte can conclude with considerable certainty that the current market is stable, operating effectively and is similar to markets in other jurisdictions in Australia. The potential benefits from competition are modest – in our calculations, a burst of lower prices, followed by (modestly) higher average premiums. It is theoretically possible that prices offered by a new entrant could be similar to that charged by Lawcover currently, but this would require a substantial reduction in administrative costs such that administrative costs as a share of claims expenses are substantially below the average of commercial insurers.

A key risk is that in a more competitive market, the volatility of insurance cycles is passed on to solicitors in the form of volatile premiums. There are circumstances in which a hardening of the insurance market could see some firms left unable to get insurance. The report outlines a number of structures to mitigate risks – price regulation, policy monitoring, risk-pooling and risk management levies. These are complex areas and could take years to develop and implement.

1 Introduction

The NSW Department of Communities and Justice (the Department) commissioned this report in order to provide an independent assessment of the implications of approving one or more new entrants to provide professional indemnity insurance (PII) policies for solicitors operating in NSW. The Department is interested in a range of considerations, including how approving one or more policies may affect premium stability; the accessibility, coverage, and stability of the market for solicitors' PII; and the adequacy of cover. It is also interested in whether any change could raise the potential for NSW solicitors to be unable to obtain insurance at an appropriate and reasonable price, and the impact of this on the protection of clients of NSW Solicitors.

Currently, solicitors' mandatory minimum level of PII in NSW is predominantly provided to the market through one insurer, Lawcover. There are exceptions for corporate legal practitioners, government lawyers and interstate or national law firms that have PII through another state's scheme. The Proponent Insurer, a consortium of ABC Insurance (ABC) and Liberty Specialty Markets (Liberty), have proposed providing an alternative PII Policy for solicitors practicing in NSW as a market competitor to the current Lawcover policy. The consortium has submitted its policy for consideration by the NSW Attorney General.

To support the Department in its response to the Attorney General about the market impacts of approving one or more additional policies, Deloitte has considered the potential impacts to the NSW market for solicitors' PII of three scenarios:

- (Scenario 1) continuing the current state of PII, where Lawcover is the predominant insurer;
- (Scenario 2) approving the Proponent Policy, with the Proponent and Lawcover acting as two competing providers; and
- (Scenario 3) enabling an open market, with multiple insurers offering PII coverage.

In order to provide a robust assessment of the implications of each scenario, Deloitte has sought to ensure that the analysis contained within this report is comprehensive in scope, covering:

- An assessment of the Proponent Policy for PII coverage in the NSW solicitor market, including whether it meets the minimum standards set out by the Legal Profession General Uniform Rules 2015, any differences to the Lawcover policy and the ability of the Proponent to underwrite potential claims.
- An assessment of the current state of the NSW solicitors' PII market.
- Derived insights from comparator markets, including:
    - Solicitors' PII in other Australian jurisdictions;
    - Solicitors' PII in overseas jurisdictions; and
    - Other profession PII within Australia.
- An actuarial modelling-based scenario assessment of the impact of an additional one or more insurers entering the NSW solicitors' PII market.
- A discussion of potential structures that could help mitigate any risks emerging from entry into the market by one or more additional insurers.

The Department has requested that the current market be evaluated based on the following criteria: market stability, premium stability, accessibility, affordability, market coverage, and consistency with other jurisdictions.

For the scenarios, the analysis undertaken here is based on a range of data and has qualitative and quantitative components. Each of the scenarios is assessed based against the criteria defined by the Department, namely market stability, premium stability, accessibility, affordability, and market coverage. The analysis is considered in the short term and long term.

To support the analysis of both the current state and the scenarios, Deloitte has been provided with a number of reports completed by Finity, Lawcover's appointed actuary. These Finity reports have been used as evidence to inform this report, but the analysis has not been independently verified by Deloitte. In addition to this, further evidence has been collated across previously commissioned reports investigating the NSW solicitors' PII market (primarily Taylor Fry's previous market review), publicly available data, and academic research.

The assessment is considered through the following sections:

- Chapter 2: Assessment of ABC.
  Providing an overview and assessment of the Proponent policy.
- Chapter 3: Evaluation of Current Market
  Overview of the purpose of solicitors' PII in NSW and assessment of the current state.
- Chapter 4: Impacts of a Competitor
  Implications from economic theory, the distinct nature of PII and its implications, and key evidence from other markets.
- Chapter 5: Scenario 2 analysis: ABC enters the market.
  A qualitative and quantitative analysis of the implications of ABC entering the NSW solicitors' PII market, reviewed against the evaluation criteria.
- Chapter 6: Scenario 3 analysis: open market.
  A qualitative and quantitative analysis of the implications of multiple new entrants to the NSW solicitors' PII market, reviewed against the evaluation criteria.
  Chapter 7 Potential mitigating structures
  Outlining potential structures to mitigate the risks presented to market stability, premium stability, market coverage and the overall effectiveness of the model through the introduction of one or more new market entrants.

Further to this, the appendices contain [redacted], the market for solicitors' PII across other Australian jurisdictions, the international market for solicitors' PII, alternative Australian PII markets, and [redacted], as well as further explanation of the scenario analysis modelling undertaken in Chapters 5 and 6.

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3 Evaluation of the current market

This chapter analyses the current state of the NSW Solicitors' PII Market based on a range of assessment criteria. The current arrangements with Lawcover as the sole provider of PII to solicitors is referred to in this report as Scenario 1. Understanding the current market is important in order to provide a baseline against which alternative scenarios e.g. Scenario 2 (the entry of a single competitor to Lawcover) and Scenario 3 (multiple entrants) can be compared. The evaluation of the current market is based on current and historical performance and provides a reference point against which outcomes under alternative scenarios can be considered.

3.1 Objectives of solicitors' PII in NSW

The Department has indicated that its initial assumptions, to be tested through analysis, are that:

- The NSW solicitors' PII market is stable, affordable and accessible over the short, medium and longer terms.
- NSW solicitors are adequately covered for claims of professional negligence, including through run-off cover.
- Where NSW solicitors are professionally negligent, their clients can access appropriate levels of insurance payouts.
- The market is sufficiently robust to enable citizens to access legal help when they need it, including vulnerable cohorts and people experiencing disadvantage.

With these core objectives in mind, the Department have asked for the current market to be evaluated based on the various criteria outlined in Figure 3.1 below.

Figure 3.1 : Assessment criteria recommended by the Department to evaluate the current solicitors' PII market in NSW.

Source: Deloitte.

The ability to assess the performance of the current market against these criteria is largely dependent on a range of information, including that which is publicly available, and other information provided by the Department, Lawcover, and other insurers. Deloitte has sourced information from the law society annual reports of various Australian jurisdictions, as well as other public information sources. APRA institutional level data have been sourced for Lawcover as a sense check against the annual report figures.

To assess consistency with other jurisdictions, Deloitte has conducted comparator studies in relation to interstate solicitors' PII market, specifically the experiences of Victoria (VIC), Queensland (QLD) and Australian Capital Territory (ACT).

3.2 The solicitors' market in NSW

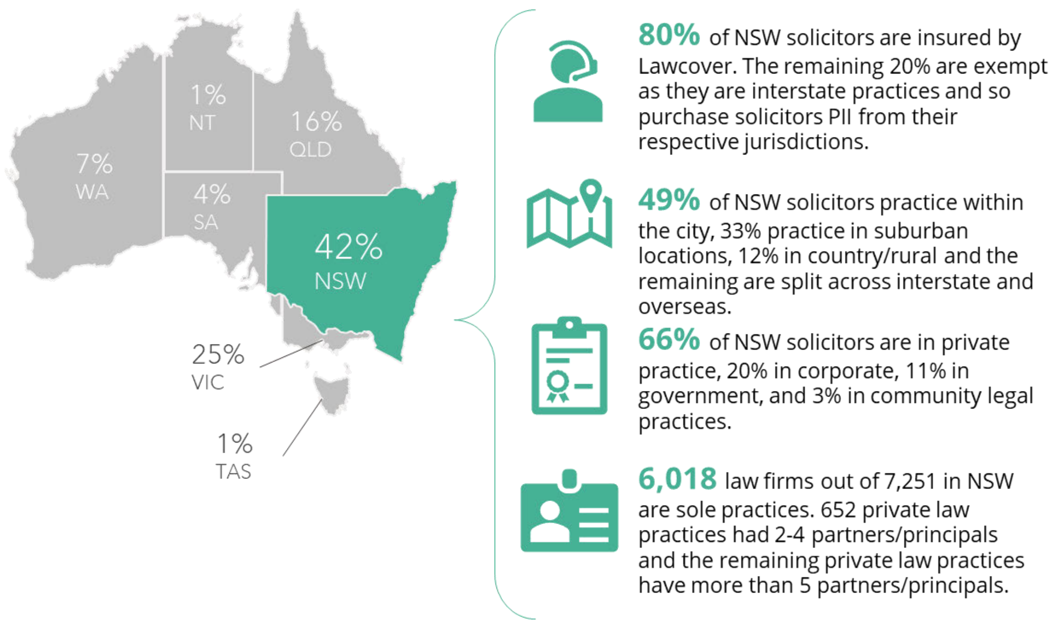
The biennial Urbis report, commissioned by the Law Society of NSW on behalf of the Conference of Law Societies, compiles a national profile of practicing solicitors in Australia. These reports are prepared based on data provided by state and territory law societies and regulators which license solicitors to practice.

NSW is the largest market for solicitors in Australia, with VIC and QLD ranking 2nd and 3rd respectively. As of 30 June 2023, there were **40,745** practicing solicitors in NSW.[7] This figure accounts for 42% of all solicitors practising nationally.[8]

7 The Law Society of New South Wales 2023, 'Practising Solicitor Statistics', <http://www.lawsociety.com.au/sites/default/files/2023-07/202306%20Practising%20Solicitor%20Statistics%20-%20Jun%202023.pdf>.
8 Urbis 2023, '2022 National Profile of Solicitors', for The Law Society of New South Wales, <http://www.lawsociety.com.au/sites/default/files/2023-05/2022%20National%20Profile%20of%20Solicitors%20-%20Final.pdf>.

Figure 3.2 summarises some key statistics around the current solicitors' market in NSW based on location, area of practice and size of practice.

Figure 3.2 : Current profile of solicitors' market in NSW



Source: Deloitte drawing on information from Urbis 2023.

Lawcover does not cover all solicitors in NSW, with many interstate practices (accounting for around 20% of the market) exempt from purchasing cover from Lawcover.

In terms of the market segments that the Department is particularly interested in, the current market landscape is dominated by sole practices and small legal firms, where sole practices are defined as law practices with one partner/principal. This highlights a potential area of vulnerability in the current market, because compared to large law practices, this cohort of small to medium practices would not have the same level of resources or capital buffer to shield them from adverse external experience drivers such as an increase in premiums.

Community legal centres account for around 3% of the current market at a national level, with the highest concentration of solicitors employed in community legal located in the Northern Territory (18%).[9]

3.3 Current state analysis under Lawcover

3.3.1 Affordability and accessibility

Price affordability is an important consideration for the Department, as cover needs to be affordable to be accessible for solicitors. If premiums are too high in general, or for certain areas of law that are higher-risk, this could cause solicitors to exit the market, and have impacts across all communities but possibly lead to outsized impacts for vulnerable communities.

Lawcover's current base premium algorithm applies a percentage rate to a company's previous financial year's gross practice fee income (GFI). The percentage rate is calculated relative to the GFI of the practice, decreasing for GFI estimates above $200,000. Discounts are applied to the base premium for claims experience, participation in risk management activities, ISO 9001 – Australian Standard Certification and criminal law practices.[10]

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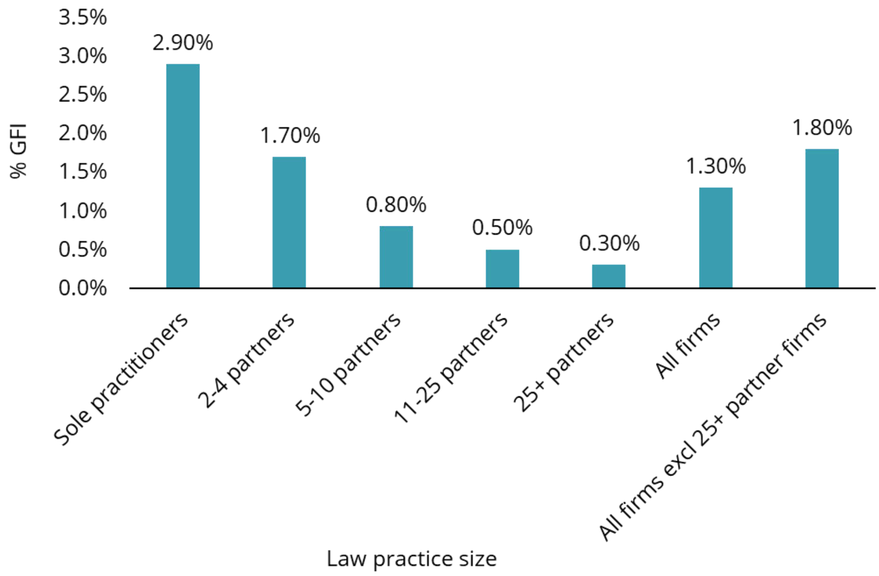
9 Ibid.

10 Lawcover n.d., 'How We Calculate Your Premium', <https://www.lawcover.com.au/how-we-calculate-your-premium/>.

In practice, the average gross premium as a portion of GFI decreases with size of practice as shown in Figure 3.3. This indicates that premiums as a proportion of GFI are relatively higher for smaller firms.

In the current NSW market, every active participant can access cover in the solicitors' market, with maximum premiums being approximately 4% of gross fee income.[11] Overall, this suggests that the current market provides both accessible and relatively affordable coverage for law practices.

Figure 3.3 : Mean gross premium as a proportion of gross fee income (GFI)



Source: Law Society 2023.

From annual reports of the professional indemnity insurers in Victoria, Queensland and NSW, as well as information from the Lawcover website, Deloitte has sourced the number of practicing solicitors and the corresponding premiums paid in each financial year in 2023. Figure 3.4 compares the indicative average premium and claim experience for solicitors in NSW, VIC and QLD in 2023. Some care should be taken in drawing comparisons from these figures. Firstly, they may include some top up cover above the compulsory minimum level of PII. Secondly, some premiums for barristers are included for Victoria (although PII costs for barristers are relatively low and they only account for approximately 10% of practitioners). Thirdly, while information on the number of solicitors covered has been taken from annual reports or information requests, it is possible that these figures may not align perfectly with financial information.

11 Lawcover 2024, 'Lawcover response to Deloitte clarification questions'.

Figure 3.4 Comparison of premium and gross claims per solicitor for NSW, VIC and QLD, FY23

Source: Deloitte analysis.

Comparing the indicative premium per solicitor, in the top three jurisdictions by solicitor volume, Deloitte observe:

- The level of indicative premium per solicitor varies between the states, with NSW and Queensland having the highest premiums per solicitor.
- Victoria has the lowest indicative premium per solicitor. Finity carried out a 2010 analysis on the differences in claim cost, a significant driver of premiums, using information available at the time. Finity identified the key driver in the differences in claims costs to be:
    - Victoria experiencing a more benign claims environment.
    - Greater weighting of the Victorian solicitors' PII market towards lower cost large firms (including some interstate firms.
- Victoria's premiums have a much lower margin between indicative premium and claim cost per solicitor. The professional indemnity insurer in Victoria (LPLC) has a more efficient administration expense function than Lawcover or Lexon in Queensland. Underwriting expenses were 16% of gross claims in Victoria compared to 30% in NSW and Queensland. The 1998 Trowbridge report noted that administrative costs for the LPLC were significantly lower than for Lawcover.[12]

As another point of comparison, the cost of PII in Tasmania for a full-time solicitor was $4,103 in 2023-24, a reduction from $5,040.75 in 2022-23. The cost for 2023-24 is similar to Queensland, although part time solicitors and low fee earners qualify for lower premiums.

Table 3.1: compares the outcomes of Lawcover in NSW, ACT and NT with other jurisdictions in Australia and internationally, where affordability is expressed in terms of premiums as a share of Gross Fee Income. Data on this measure is not readily publicly available for all jurisdictions, meaning that figures are reported for the latest period for which the data could be readily sourced. This can lead to some important differences. For example, the figures for Queensland are from the 2022 financial year, although premiums had a dip in 2022 relative to 2021 and 2023. Similarly, the figures for Scotland are relatively dated and precede the hardening of the market in the UK in recent years. Nonetheless, while acknowledging these caveats, the evidence suggests that premiums as a share of GFI in NSW are broadly in line with other Australian jurisdictions (although possibly slightly higher). NSW premiums also appear similar to premiums in Scotland, which has a single provider,

12 Trowbridge Consulting 1998, 'Actual review of cases for retaining LPLC as Monopoly Insurer', a report to the Legal Practice Board.

but significantly lower than premiums in England and Wales, where multiple insurers serve the market.

Table 3.1: Comparison of average premiums as a share of GFI across jurisdictions

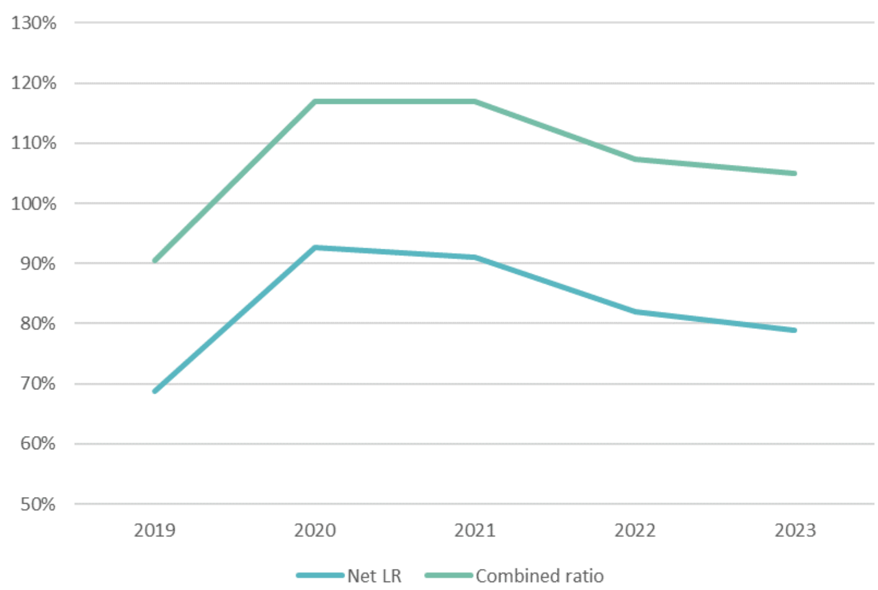
Jurisdiction	NSW, ACT and NT	Queensland	WA	England and Wales	Scotland
Estimated number of solicitors covered	23,000	8,850	6,737	159,000	12,200
Average Premium as % of GFI (latest available figure)	1.30% (FY23)	0.9% (FY22)	Base premium of 1.1% or less for firms with GFI>$100,000 (FY24)	5% (FY23)	1.5% (FY18)
Range of premiums as % of GFI	Average ranges from 0.3% (large firms) to 2.9% (single partner firms) practice	Not available	Base premium ranges from 0.46% to 3.91% depending on GFI	Typical ranges between 3% to 9% of annual turnover, median value of 5%	Not available

Source: Lawcover 2023, Queensland Law Society Annual Report 2022-23, Law Mutual Annual Information Booklet 2024-25, Frontier Economics 2023, 'Econometric analysis of professional indemnity insurance costs for legal service providers', The Law Society of Scotland Master Policy for Professional Indemnity Insurance and its Administration 2018, Annual Report.

3.3.2 Premium stability

Lawcover has in recent years held capital well in excess of the APRA regulatory minimum, and used this to support the stability of premiums over time (as have its counterparts in Victoria and Queensland). Figure 3.5 outlines Lawcover's reported net loss ratio (net incurred claims/net premium earned) and combined ratio (net incurred claims + underwriting expenses/net premium earned) over the last five reporting periods. Lawcover have been operating at a combined ratio above 100% since 2020, suggesting premiums have not been adequate to cover claims costs and expenses.

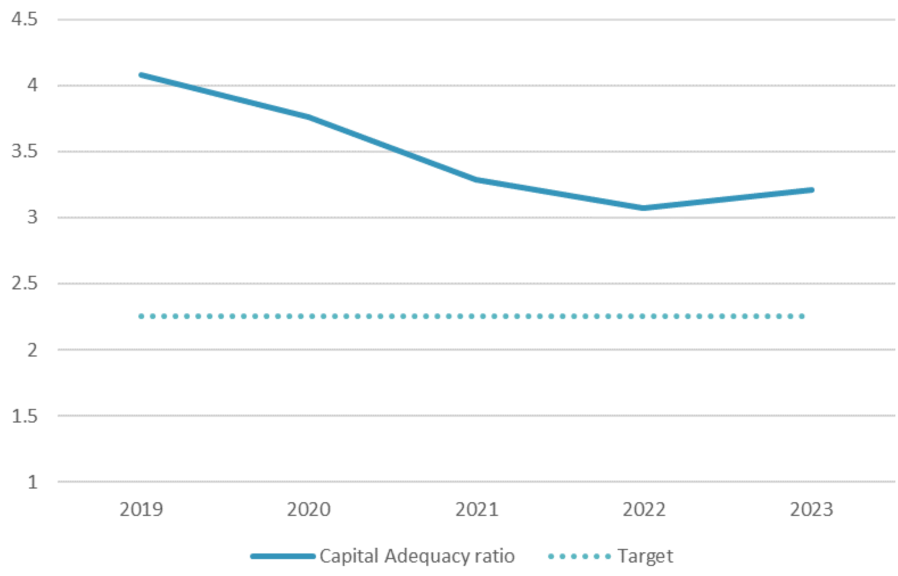
Figure 3.5 Lawcover net loss ratio and combined ratio



Source: APRA published statistics.

Lawcover has been able to have a combined ratio over 100% because it has built a very strong capital position in prior years, with its capital ratio sitting at four times the APRA requirement in 2019. This is significantly above Lawcover's internal target of 2.25 times the APRA requirement. With increased claims costs and expenses in recent years, Lawcover have utilised this capital to offset growing costs. This is evident from Lawcover's reduced capital position as outlined in Figure 3.6, and has contributed significantly to premium stability during unfavourable periods of the insurance cycle.

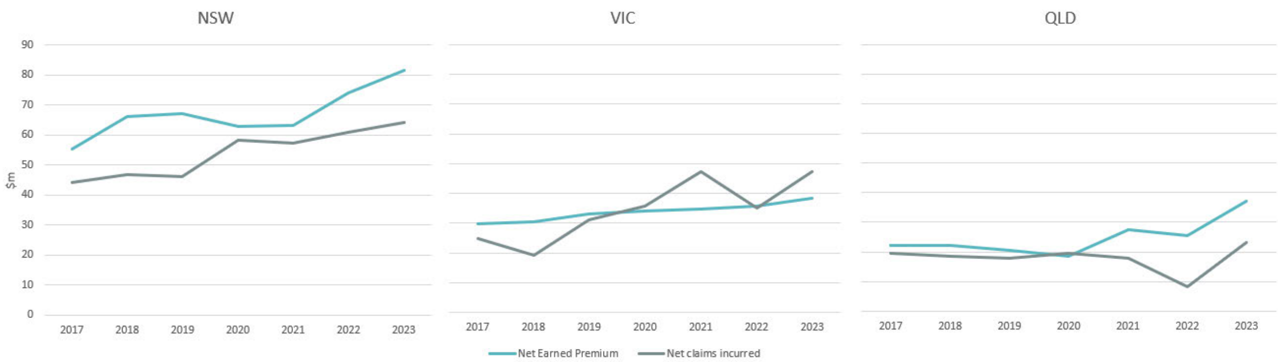
Figure 3.6 Lawcover capital adequacy ratio



Source: APRA published statistics.

Deloitte was not able to obtain data on average premiums and claim levels by area of law. However, Figure 3.7 draws on data from annual reports to compare net earned premiums to net claims incurred by financial year across NSW, Victoria and Queensland. This is equivalent to a net loss ratio.

Figure 3.7 : Net earned premium vs net claims incurred for NSW, VIC and QLD



Source: APRA published statistics

Comparing the net earned premium against net claims incurred for the top three jurisdictions by solicitor volume, Deloitte observes:

- Net earned premiums are consistently higher compared to claims incurred in NSW, while the experience is more in line across VIC and QLD until 2020.

Although claim costs are the primary driver of premium rates, rates also need to be set to cover underwriting expenses. Using publicly available data, Deloitte has also compared net earned premium against net incurred claims plus underwriting expenses across NSW, Victoria and Queensland.

Figure 3.8 : Net earned premium vs net claims incurred + underwriting expenses

Source: APRA published statistics

Comparing the net earned premium against claims incurred plus underwriting expenses for the top three jurisdictions by solicitor volume Deloitte observes:

- Since 2020, NSW and Victoria have been operated at an underwriting loss. That is, premiums have not been adequate to cover the cost of claims and expenses.
- None of the three schemes considered have set premiums at a level intended to earn excess profits, as are often associated with monopolies.
- All jurisdictions have had reasonably stable premiums since 2017 and have been using investment returns to keep premiums at a low or reasonable level when compared to claim costs and underwriting expenses.

In particular, NSW and Victoria have been able to use capital and investment returns to moderate increases in premiums in response to upward trends in net claims incurred.

3.3.3 Market stability

On the whole, the solicitors' PII market in NSW has been relatively stable. While total premiums have trended upwards, this in part reflects growth in the number of solicitors covered. Premiums have been relatively stable. Lawcover remains well capitalised.

3.3.4 Market coverage

Lawcover currently provides solicitors' PII to about 80% of solicitors in NSW. Deloitte is not aware of any evidence that solicitors are currently having issues accessing suitable insurance to meet their mandatory minimum requirements. There have been some challenges in accessing insurance by community legal centres, although they typically adopt alternative insurance arrangements. Lawcover developed insurance for community legal centres in 2021 in response to a request from the Law Society of NSW, although Deloitte understands that relatively few community legal centres are covered by Lawcover.

3.3.5 Effectiveness of risk management

Lawcover claims a strong focus on risk management and education, which is part of their early intervention focus, to prevent a deterioration in experience translating to adverse claims and premium experience.

Analysis of the impact of Lawcover's risk management activities on claims cost savings has been conducted by Finity. The findings are summarised below, with the caveat that Finity's analysis has not been reviewed or independently verified by Deloitte.

Summary of Finity findings (not reviewed or independently verified by Deloitte)

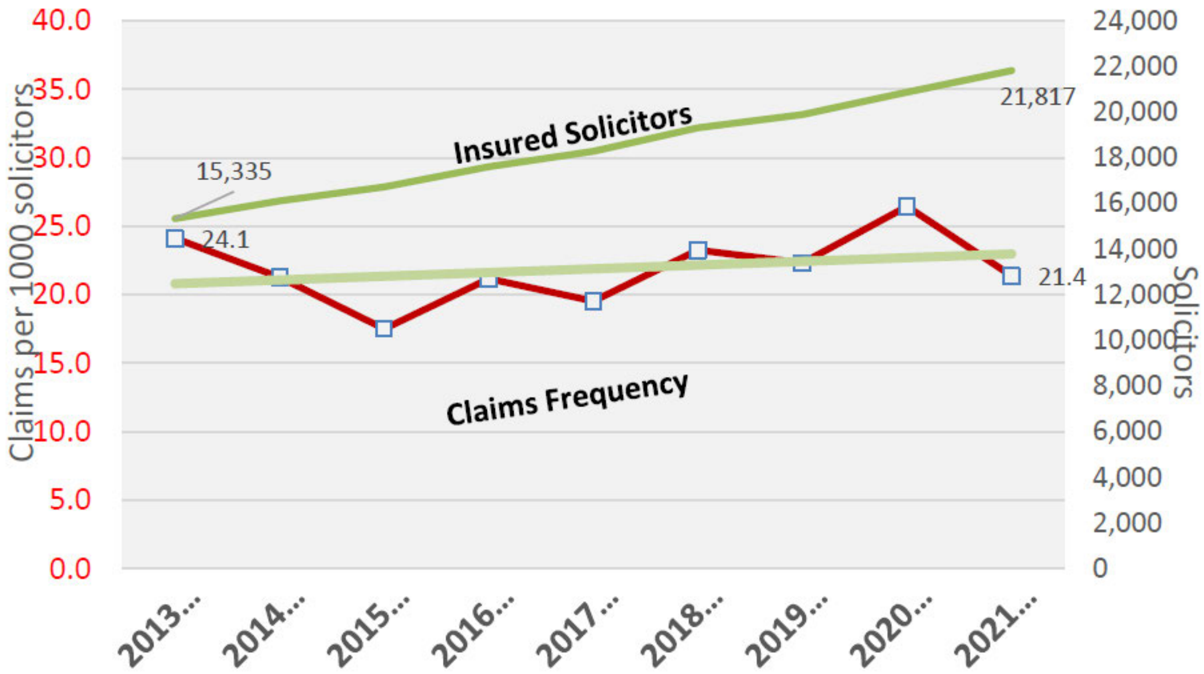
Programs offered by Lawcover include the Risk Management Education Program (RMEP), Practice Advisory Service (PAS), and Adverse Risk Category (ARC). While all programs provide a return on expenses, PAS/ARC activities generate the largest benefits. Collectively, expenses for these risk management programs sit at $1 million. Net of these expenses, estimated claims costs savings (over and above expenditure on the program) range from $0.1 million (low estimate) to $3 million (high estimate) a year.

PAS provides targeted risk management advice to firms with a historically poor claims experience. ARC requires riskier firms to comply with the Lawcover Action Plan to avoid the addition of an ARC loading to their premium. While ARC participation has remained consistent since inception, PAS participation has declined since 2017. PAS/ARC participation substantially reduces the loss ratio of firms. PAS visits are more effective than ARC, with firms reducing their loss ratio from 4 to 6 times the Lawcover ratio to 1.5 times the Lawcover ratio after the program. Finity notes that loss ratio improvements could be due to solicitors who generate claims leaving the firm, or the firm reducing its activity in claim-prone areas. With the assumption that the loss experience would have continued at high levels if not for the intervention, each PAS/ARC visit generates an estimated $35,000 to $100,000 annual saving.

RMEP refers to a voluntary suite of workshops offered by Lawcover on a range of risk management topics such as maintaining proper policies and procedures, strategy development, and satisfying clients. Additional activities to complement the program include a claims prevention roadshow, risk briefings and a support staff workshop. RMEP participation increased in 2021. Firms participating in RMEP have a 14% lower average claim size and have been found likely to generate cost savings, though this cannot be quantified with precision due to limited data.

To assess the effectiveness of risk management, it is useful to consider claim frequency which is defined as number of claims reported divided by the number of practicing solicitors each year. This is because if risk management practices are effective, then Deloitte would expect to see a decreasing claims frequency over time as the risk management capabilities of solicitors and law practices are uplifted by Lawcover. Figure 3.9 contains some data provided by Lawcover on claims frequency over time, which is expressed as claims per 1,000 solicitors. Overall, claims frequency is relatively stable. This suggests that the likelihood of claims has not risen or fallen and that risk management activities have not reduced the frequency of claims since 2013. However, the RMEP program has been operational since 1995, so many of the gains from risk management may have already occurred prior to 2013, while continued risk management may be required to maintain the status quo.

Figure 3.9 NSW claim frequency over time



Source: Lawcover 2024.

3.3.6 Consistency with other jurisdictions

Another criterion for evaluating the current market is whether solicitors' PII arrangements in NSW place NSW solicitors on a similar footing to solicitors in other jurisdictions. This is important, as less favourable arrangements can create an incentive for law firms to establish interstate offices to benefit from more favourable insurance arrangements. All Australian jurisdictions currently have a single solicitors' PII provider, so the market structure remains similar across jurisdictions.

As noted above, premiums per solicitor in NSW appear higher than in Victoria and Queensland. However, claims are also on average higher in NSW. While administrative expenses for Lawcover are higher than that of the LPLC, they are similar to Lexon in Queensland. This suggests that some efficiencies could help reduce premiums, although Deloitte does not have enough evidence to state that Lawcover is inefficient relative to other similar bodies in Australia.

In terms of other jurisdictions, both ACT and the Northern Territory are insured by Lawcover, so NSW solicitors face no competitive disadvantage with respect to those jurisdictions. There is limited publicly available data on affordability or claims from either South Australia or Western Australia, so it is difficult to determine how the arrangements in NSW compare to those jurisdictions. The range of base premiums by Gross Fee Income in Western Australia appears broadly similar to available data from Lawcover, based on the size of individual firms.

3.4 Findings and Limitations

3.4.1 Overall effectiveness of current single provider arrangements

From analysis of the current profile of the solicitors' PII market, it is clear that the majority of law firms in NSW are relatively small. The majority are single partner firms, while further to this a large number of the remaining practices have 2-4 partners/principals. The majority of solicitors do not work in regional or rural areas.

Overall, there is no evidence that law firms are currently facing challenges in obtaining PII or of premiums being excessively high as a share of gross fee revenue in the vast majority of cases (certainly relative to the situation in England and Wales discussed in Chapter 4). Moreover, premiums and claims have been reasonably stable over the last decade.

Looking at the assessment criteria, Deloitte notes that Lawcover have been relatively effective in providing market and premiums stability, market coverage, and accessibility. In terms of affordability, the comparison between premiums and claims in NSW shows that premiums are higher in NSW, but this is at partly explained by higher claim levels. The remaining difference appears to be driven by greater administrative efficiency and a higher combined loss ratio in Victoria.

Deloitte does not have the level of granular information to consider the level of premium by location or area of practice. However, Deloitte notes that at an overall level, Lawcover is able to provide accessible cover for solicitors.

In terms of comparability, PII is provided by Lawcover in ACT and NT, and similar bodies in all states other than Victoria, where a statutory body provides PII.

In terms of risk management, while there is not clear market-wide evidence of the lower claim frequency over the past decade, analysis by Finity shows a return on investment from Lawcover’s risk management activities.

4 Impacts of a competitor

4.1 Overview

The introduction of ABC as a single new market entrant, operating as a competitor to Lawcover, could potentially be a significant change to the NSW market for solicitors' PII. This development would directly alter the market structure, with potential follow-on implications across key market outcomes, including premium stability, accessibility, coverage, market stability, and affordability.

While Chapters 5 and 6 outline two specific scenarios of market structure change, this Chapter provides an introductory discussion about the potential impacts of greater competition, the key distinctive features of PII, and evidence from other markets.

4.2 How market structures affect competitive outcomes

If ABC were to be approved as a provider of solicitors' PII in NSW, it would change the market from its current state of a single-provider (other than firms with an exemption) to a dual-provider structure. This could be summarised as moving from a monopolistic to a duopolistic market structure, whilst noting the complexity of the exemptions, and the possibility that, either in the short or medium term, one provider could exit the market.

Economic theory suggests that, under certain conditions, increased competition should result in consumers – in this case, solicitors – being better off, through some combination of lower prices or improved quality of services. In perfectly competitive markets, characterised as possessing low barriers to entry, homogenous products, and a high number of competitors, long-run economic profits are driven to zero. This maximises 'consumer surplus' as the market price reaches its equilibrium at the lowest possible price for which firms can still cover the cost of production. In the context of the market for solicitors' PII, this could be expressed as gross premiums equating to the gross cost of provision, including claims settlement, with no economic profit for the insurer.

Extending the idea of perfect competition, under certain conditions, any step towards more competition should result in better outcomes for consumers. However, there are several reasons why, in practice, it is not possible to expect real world markets to operate as simply as that. If a provider is a not-for-profit (and not 'profit-maximising'), if the service is heterogenous, or if there are market failures (such as 'information asymmetries' between producers and consumers or network externalities) then the consequences of introducing competition are less clear. PII is a service provided by Lawcover that may well indeed have some of these features that put it outside economic norms. Further, PII is reinsured, a transaction that may be more efficient and cheaper if there is one buyer (a monopsony) of NSW solicitors' PII insurance. Essentially, any arguments that the market for PII would not benefit from competition need to be very closely scrutinised, because, more often than not, more competition is good.

Finally, even if one was to find that a market is best served with a single provider, it is an altogether different proposition to suggest government should choose who that is. To analyse that, a static analysis is insufficient, and one must look at the balance between the disruptive costs of change, against the benefits of letting the market decide who is the best provider.

4.2.1 PII in the 1999 Review of the Legal Profession Act

A review of the Legal Profession Act in 1998 and 1999 by the Attorney General's Department in 1998 and 1999 canvassed many of the same issues worthy of consideration in 2024.[13,14] Some of the key points in the final report (Chapter 11) were:

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13 Attorney General's Department 1998, National Competition Policy Review of the Legal Profession Act 1987: Final Report, http://www.lawlink.nsw.gov.au/report%5Clpd_reports.nsf/pages/ncpf_toc.
14 Attorney General's Department 1999, Review of the Legal Profession Act: Final Report.

- A private insurer and the ACCC said competition in PII would lead to lower prices and better service.
- According to the report, the ACCC said "solicitors and barristers should be free to choose their insurers as long as minimum standards were met." It argued that that in any case, the threat of losing insurance would provide an incentive to solicitors to provide better customer service.
- The Law Society expressed concerns about lower cost products providing lower levels of cover, and that a deregulated insurance market could see some solicitors (especially those in high-risk areas of practice) being excluded from the market.
- Recognising the value of risk management activities, it recommended that a "percentage from the premiums paid by solicitors and barrister be paid to the Law Society and Bar Association respectively, to be used by the regulatory bodies for developing and providing risk and practice management training. Each of the regulatory bodies would be required to account for the funds in the annual reports."
- Recognising the potential for solicitors' exclusions, it recommended "an 'assigned risk pool', where all insurers are required to accept a certain number of high-cost practitioners, or a maximum differential between the minimum and maximum premiums which could be set."
- It recommended not limiting deregulation of the insurance market for solicitors' PII, but commencing with a trial period where a maximum of three insurers were permitted.

4.3 The distinct nature of PII and its implications

PII has several distinctive characteristics, which are important considerations when assessing the impact of competition on PII.

4.3.1 Liability insurance

Unlike many lines of conventional insurance, where risks are often linked to external factors, PII places emphasis on the insured's actions or omissions, which can result in legal liability. This characteristic exacerbates the moral hazard inherent in any market for insurance, as it directly ties the risk insured to the policyholder's skills, business practices, and conduct. Consequently, professionals may be incentivised to take risks or engage in behaviours that increase the likelihood of claims, knowing they are protected by their insurance coverage. This dynamic presents a challenge for insurers in accurately assessing and pricing risks, as well as for regulators aiming to ensure responsible professional conduct.

4.3.2 Long tail insurance

PII claims frequently exhibit a prolonged period between the occurrence of the wrongful act and the filing of a claim, leading to what is referred to as a 'long tail' in insurance terminology. This delay stems from the nature of claims related to economic loss caused by defective advice, which may only materialise when the claimant suffers actual damages. As a result, insurers face uncertainty in estimating the potential outcomes and recoverable losses associated with these claims, complicating risk assessment and management. The long-tail nature of PII claims also poses challenges for policyholders, as they may experience financial and reputational impacts years after the initial incident, highlighting the need for comprehensive coverage and risk mitigation strategies.

4.3.3 Complexity

The complexity inherent in PII claims further distinguishes this type of insurance from others. The multifaceted nature of professional services and the intricacies of legal disputes make it challenging to accurately predict claim outcomes and assess liability. Factors such as evolving regulations, diverse client needs, and the subjective nature of professional advice contribute to the uncertainty surrounding PII claims. Insurers must navigate this complexity when underwriting policies and processing claims, requiring specialised expertise and robust risk management frameworks. Additionally, the uncertainty surrounding claim outcomes can lead to volatility in insurance markets, impacting premiums and coverage availability. Thus, the distinctive characteristics of PII underscore the need for tailored approaches to risk assessment, regulation, and claims management within the insurance industry.

4.3.4 The purpose of PII

The primary purpose of PII is to protect clients of the insured, rather than the insured party itself, which is distinct from regular insurance. To the extent that it operates as a form of regulation, it reduces the likelihood of the adviser engaging in conduct that results in loss. Furthermore, it reduces the likelihood that, if a client does suffer a compensable loss, that the client's claim will not be met by the adviser due to lack of financial resources.

4.3.5 Mandated Product

PII protects a client from not receiving compensation from a lawyer due to lack of financial resources.

It is worth observing at the outset that imposing a requirement on a profession or occupation to hold PII is only possible if the insurance market is willing and able to provide cover on terms that are affordable and meet the cover specification.

There are important consequences arising from compulsion for the insurer and the insured, particularly where a single insurer or a limited group of insurers is specified. The first is that it removes or reduces the potential for adverse selection, that is, those with little risk (or who believe they have little risk of a claim) are not able to choose to go bare, reducing the premium pool and driving up the cost of the cover for those who insure and may have higher risks. The second is that it permits pricing that involves some cross-subsidy between the insured and reduces the need to precisely price the individual risk associated with each insured.

4.3.6 PII as regulation

One of the ways in which PII is said to operate as a form of regulation is through insurers adjusting the terms on which they offer cover in order to reduce their risk. This can be done in a number of ways: for example, the insurer may decline to provide cover in particular situations or by adjusting the premium to reward steps taken by insureds to reduce their risk. Baker and Logue argue that insurers are better placed to do this than government, because of the unique access they have to claims information over time. This allows insurers to identify risks in practice that are associated with a higher frequency of claims. However, the long tail of PII, the extended period between an instance of professional negligence and its impact on the practitioner's insurance status allows room for misconduct to persist long after the negligent act has occurred. Haller goes even further than this, stating:

"the potential time-lag between an act of professional negligence and a claim having an effect on the practitioner's insurance position may lead a practitioner who needs income in the short term to conclude that the risk of having to pay a self-insured excess and an increased insurance premium some years in the future is worth taking, and so undertake work at a level of difficulty or at a volume beyond his or her capacity."[15]

In addition, if an insurer could deny cover to riskier professionals, this would run counter to the public interest reasons for mandating PII, identified above. In those cases, such as with the law societies, where arrangements are in place between a professional association and a particular insurer or insurers, it seems that insurers are more willing to provide cover to all those professionals who qualify for membership of the relevant professional association. In other words, the 'gatekeeper' function sometimes ascribed to an insurer's decision to refuse cover is in fact being performed by the professional association, and not the insurer.

4.3.7 Feedback loops to reduce PII risk

A feedback loop is where information about risks is collected on a profession-wide basis and used to create risk management strategies and programs for the benefit of members. The intention is to improve professional practice and reduce the risk that clients will suffer loss. The feedback loop is a central feature of the professional standards schemes created under the professional standards legislation discussed above. Under each scheme, the relevant professional association is required to

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15 Haller, L 2010, 'Professional discipline for incompetent lawyers? Developments in the UK and Australia', International Journal of the Legal Profession, 17(1).

collect comprehensive data about the claims experience of its members and report that information annually to the Professional Standards Councils (PSC).

According to Morgan and Hanrahan: "One observation of a number of the PII arrangements is that where there is a close connection between the relevant professional body and the insurer or insurers there is more active feedback to the professional groups on risk management and the causes of claims. For example, Lawcover provides premium discounts for meeting certain risk management requirements. These risk management requirements are informed by their claims analysis and the publication of information on a regular basis. This alerts members to take particular care in certain areas. The other legal professional associations take a similar approach."[16]

The same paper notes that in 2015, Lawcover explained that:

"Of the claims made against solicitors in the last financial year, 45 were due to failure in communication between the solicitor and client. In a further 32 of claims, documentation errors and failure in the law practice's systems were identified as the causes. More than three in four claims were therefore attributable to communication, documentation and systems problems."[17]

This accords with information from other insurers on the underlying causes of claims and provides important feedback for the individual professional and for the formulation of risk management programs. It appears that the discounts given for risk management are clearly related to the actual claims experience of the professional group.

4.4 Evidence from other markets

4.4.1 Markets for solicitors' PII in other Australian jurisdictions

All jurisdictions in Australia currently use a single provider for solicitors' PII. Providers are regulated by their state's Law Society and range from captive insurers (in the case of Lexon in QLD) to statutory schemes (Legal Practitioners' Liability Committee (LPLC) in Victoria).

The ACT for many years had more than one provider in the market until Gallagher (underwritten by Liberty) withdrew in 2021 shortly before the renewal period, leaving Lawcover to provide cover for the majority of ex-Gallagher practices.

In the NT, the Law Society had previously had an arrangement with QBE. However, after some years of premium increases and the likelihood a further 10% to 20% premium increase, the Law Society approached Lawcover to become the PII provider in late 2018.[18]

Prior to these experiences, a number of reports have concluded that a single provider model provides significantly more benefits to the legal profession than a competitive market. A 2004 PwC review of the Victorian experience recommended continuing with the single supplier arrangement for solicitors, noting that the benefits outweigh the costs.[19] This recommendation was also subsequently adopted by Victorian barristers. As the sole Victorian provider for PII for private practices, the LPLC asserted in a 2014 submission to Senate that it was able to provide higher quality, more comprehensive cover at lower premium prices to legal practices, compared to a competitive market.[20] An earlier actuarial report by Trowbridge Consulting in 1998 had similarly recommended that the LPLC statutory scheme was more likely to result in cost savings than opening the market to competition.[21]

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16 Morgan, J K & Hanrahan, P 2017, 'Professional Indemnity Insurance: Protecting Clients and Regulating Professionals', Thematic: Professional Indemnity Insurance, 3: 368.
17 Lawcover 2015, as cited in Morgan, J K & Hanrahan, P 2017, 'Professional Indemnity Insurance: Protecting Clients and Regulating Professionals', Thematic: Professional Indemnity Insurance, 3: 369.
18 Law Society 2013 'Letter from the Law Society to DCJ'.
19 PWC 2004, 'NCP Review of Legal Practitioners Bill'.
PWC 2004, 'NCP Review of Legal Practitioners Bill'.
20 Legal Practitioners' Liability Committee 2014, 'Access to Justice Arrangements: Submission to the Draft Productivity Commission Report, Draft Recommendation 7.3'.
21 Trowbridge Consulting 1998, 'Actuarial Review of Cases for Retaining LPLC as Monopoly Insurer', Review of Professional Indemnity Insurance Arrangements for Solicitors in Victoria: The Role of the Legal Practitioners

Similar to NSW and Victoria, Queensland also operates under a single professional body as an insurer (Lexon). In a 2014 submission to the Productivity Commission, the Queensland Law Society suggested that key benefits of their arrangement included broader coverage available to practices than would be provided by the commercial market, as well as the maintenance of stable and affordable premiums, particularly for smaller practices.[22]

Further details on the PII arrangements in different Australian jurisdictions is provided in Appendix B.

4.4.2 Market for solicitors' PII in England, Wales and Scotland

The experience in England and Wales provides an interesting case study of market dynamics going from a single-provider to an open market. An open market was introduced in 2000, following a case of miscalculated premiums by the profession-run provider, Solicitors Indemnity Fund (SIF), which led to a 50% increase in premiums and forced law firms to exit the market. This triggered a vote in favour for an open insurance market.

While the introduction of a competitive market led to soft conditions with competitive prices for more than a decade, the market has hardened since 2018 due to the underperformance of PII as a class of insurance business. Premiums have continued to increase, with riskier firms such as smaller practices often paying significantly higher premiums than other firms.

The difficulty in navigating the PII landscape requires an additional layer of brokers. Competition has generally reduced market stability in England and Wales and is characterised by high churn rates of insurers. Since 2018, rising premium rates has resulted in law firms paying a median premium rate of around 5% of their annual turnover.[23] For high-risk law firms (smaller and conveyancing firms), the median premium rate increases to between 6.7% to 8%.[24]

Weak economic conditions have also reduced the risk appetite of the insurance market, and insurers have become more selective when choosing firms to cover. As a result, in the 2.5 years before October 2023, 46 law firms have been unable to secure PII and have dropped out of the market.[25]

By comparison, Scotland has for a long time retained a master policy under which a broker (Lockton) acquires insurance on behalf of the entire profession, an arrangement similar to that adopted by the Australian jurisdictions. Premiums have been relatively stable in Scotland and market coverage issues have been minimised. As shown in Table 3.1: premiums as a share of GFI in Scotland have averaged 1.5% in 2017-18 (the latest year of publicly available data).

This is broadly similar to recent figures for Australian jurisdictions which also have a single insurance provider, but well below that of England and Wales, where the average premium is estimated to be 5% of Gross Fee Income. It should be noted that the insurance market did harden after 2017-18 and it is possible that premiums may have changed in Scotland since this time.

A more detailed discussion of the PII market in England and Wales as well as Scotland is set out in Appendix C.

4.4.3 Market for other PII in Australia

As part of the comparator study, Deloitte also examined PII for other professions including engineers, accountants, medical practitioners and barristers in the Australian market. Deloitte note that different professions have different market structures unlike the sole provider market

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Liability Committee, A Report and Recommendations to the Honourable Jan Wade, MP, Attorney General for the State of Victoria, 3: 5.

22 Queensland Law Society 2014, Productivity Commission Draft Report - Access to Justice Arrangements.

23 Frontier Economics 2023, Econometric Analysis of Professional Indemnity Insurance Costs for Legal Service Providers.

24 Ibid.

25 Hyde, J 2023, 'Firms go under as PII premiums soar to 20% of turnover', *The Law Society Gazette*, 16 January, < https://www.lawgazette.co.uk/firms-go-under-as-pii-premiums-soar-to-20-of-turnover/5114792.article>.

structure for solicitors' PII in jurisdictions in Australia. Deloitte has selected these four professions as they all have an advisory element.

4.4.3.1 Engineers

The market for engineers' PII is competitive. Insurers in the market face substantial risk due to the nature of engineering projects. The market has experienced premium increases and cover limitations with claims experience a key driver of these trends. PII claims increased by 125% over 2017-2021 whilst premiums grew by 63%.[26] The experience highlights that premiums are not matching the cost of risk in the industry segment. This under-pricing of risks could be due to the high degree of customisation on engineering projects that make it difficult for underwriters to assess the risks involved. Due to the nature of the experience, insurers may impose unreasonable exclusions or limitations on the policies. Premium levels and policy limitations mean that some professionals are unable to obtain affordable insurance which impacts business viability and lead to project delays or cessations of operations.

4.4.3.2 Medical/Doctors

Medical indemnity insurers include both Medical Defence Organisations (MDOs), which are typically owned or operated by healthcare professionals on a mutual basis, and private commercial insurers. In total, there are six private sector underwriters operating in Australia, all regulated by APRA. While operating under a multi-provider structure the medical PII market has experienced relative stability, with insurance remaining largely affordable for healthcare practitioners.

Market stability has been reflected in an increase of the number of insurance policies, growth in premium income for insurers and sustained capital levels above minimum capital requirements, from 2007 to 2019.[27] In the same period, premium affordability has increased for private practices, with the median premium as a share of income declining from 3.1% in 2007 to 2.5% in 2019.[28]

While membership fees have increased, median real premiums have remained steady. In part, this market stability has been brought about by a series of government schemes, introduced after the collapse of United Medical Protection in 2002, which have helped to increase accessibility, while reducing premium prices and insurer risks.

These schemes include the High Cost Claims Scheme (HCCS) where the government covers a percentage of the claim cost over a threshold amount for insurers, and the Allied Health Exceptional Claim Scheme (AHECS) where the government pays 100% of the claim cost that have exceeded an indemnity cover limit. HCCS reduces reinsurance needed by the insurer while AHECS helps insurers manage their risk exposure by capping potential payouts.

4.4.3.3 Barristers

The market for barristers' PII is open to competition in NSW, although insurers need to be approved by the bar association. There are currently four insurers operating in the market. The experience in the market has been largely positive, with minimal negative reports about the system. However, barristers are less likely to face claims than solicitors as a result of advocates immunity which reflects their ultimate duty to the court. Thus the risk of adverse claims is significantly lower, enhancing the predictability of claims and also premiums. Interestingly, Victoria chose to bring barristers under the LPLC in recent years, moving away from a competitive market.

Evidence suggests that premiums are generally considerably lower for barristers than for solicitors. For example, in 2023-24, the costs of $2 million coverage in PII in Tasmania was $974.60 for

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26Sheedy, C 2021, 'PI insurance in engineering: Beyond the rising premiums', Create Digital, 17 November, <https://createdigital.org.au/pi-insurance-in-engineering-beyond-the-rising-premiums/#:~:text=%E2%80%9CMore%20than%20that%2C%20in%20the,produced%20in%20that%20industry%20segment.%E2%80%9D>.

27 Australian Government Actuary 2020, *Evaluation of the Stability & Affordability of Medical Indemnity Insurance*, <http://aga.gov.au/sites/aga.gov.au/files/sites/aga.gov.au/files/publications/2020-11/mii_actuarial_review.pdf>.

28 Ibid.

barristers compared to $4,103 for a full time solicitor.[29] Similarly, for Victorian barristers, premiums (for those with income above $50,000) range from 0.2% to 0.6% of Gross Fee Income which is typically lower than that observed for solicitors in other jurisdictions.[30]

4.4.3.4 Accountants

Unlike solicitors, barristers, engineers and medical professionals, the requirement for accountants to hold PII is imposed contractually by the relevant professional association as a condition for membership, typically when the member holds a public practice certificate issued by the relevant body. Each association sets their own PII rules for their members, including requirements for band limits and guidance on insurance policies. While some associations partner with brokers to provide a more convenient PII option for their members, accountants are free to select their own insurance policies.

Although there are several professional associations for accountants, information about risks is collected on a profession-wide basis and used to create risk management strategies and programs for the benefit of members. The intention is to improve professional practice and reduce the risk that clients will suffer loss.

In the last few years, accounting PII insurers have faced significant losses. Reflective of PII trends in the financial industry overall, premium costs have also increased for accountants. In 2022, Taylor Fry reported that premiums for CA ANZ members with band limits above $5 million had undergone an annual increase of between 7% to 20% from 2017 to 2020. In 2017, premiums as a share of gross fees were between 0.7% and 1.6%.[31] In 2020, the range was between 1% to 2%. However, despite a hardening market, the report found that insurance was readily available for practices with band limits of under $20 million.[32]

4.4.3.5 Workers' compensation

Deloitte has also considered the performance of workers' compensation scheme in monopolistic and competitive markets. In Australia, workers' compensation can be centrally managed or privately underwritten. Centrally managed funds have a single public insurer where the central insurer is responsible for underwriting the scheme. In privately underwritten schemes most of the insurer functions are provided by the private sector through approved insurance companies who meet prudential and other prerequisites.[33] In Australia, workers' compensation is state-based with Victoria, NSW and Queensland being centrally managed, and WA and NT being privately underwritten.

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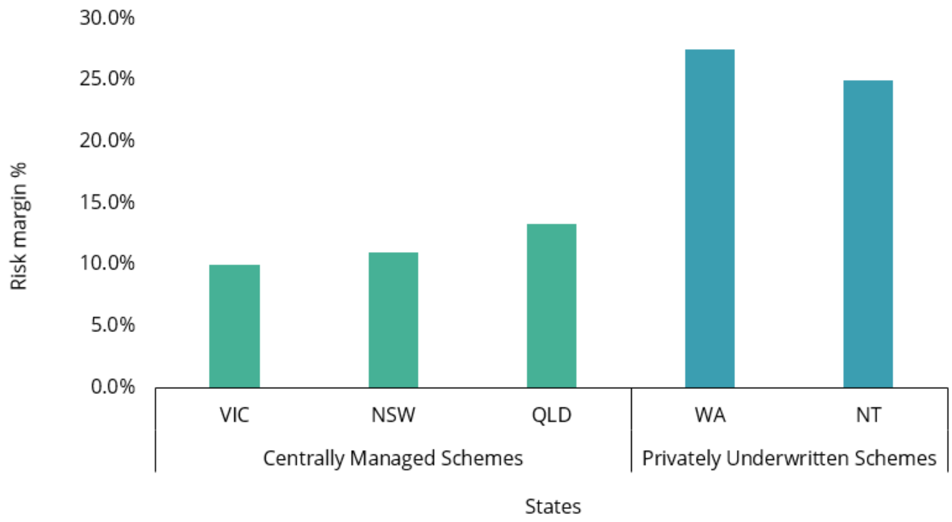
29 The Law Society of Tasmania 2023, 'Fee Guide 2023-24', <https://www.lst.org.au/wp-content/uploads/2023/05/Fee-Guide-2023-2024-v3.pdf>.
30 Legal Practitioners' Liability Committee 2023, 'Professional Indemnity Insurance for Barristers: 2023-24 Application for Insurance',< Professional Indemnity Insurance for Barristers: 2024–25 Application for Insurance (lplc.com.au)>.
31 Taylor Fry 2022, The Benefits of Professional Standards Schemes – Limitation of Liability and Consumer Protection Measures: Final Report to the Professional Standards Councils, 31 March.
32 Ibid.
33 Safe Work Australia n.d., 'Scheme funding arrangements', <http://www.safeworkaustralia.gov.au/book/comparison-workers-compensation-arrangements-australia-and-new-zealand-2021-28th-edition/chapter-8-scheme-administrative-and-funding-arrangements/scheme-funding-arrangements>.

Figure 4.1 Workers' compensation risk margin percentage by state schemes



Source: Workers' Compensation state schemes 2023 annual reports.

Risk margins reflect variability of claims experience. As such, they are a relevant measure to consider when examining comparative claims volatility. Figure 4.1 suggests that claims are less volatile in centrally managed schemes relative to privately underwritten scheme as evidenced by the lower risk margin percentage. This could be due to the provider having better oversight in a centrally managed scheme that enables them to conduct adequate risk assessment and underwriting, leading to lower volatility of claims experience. However, Deloitte note that this comparison should be taken as indicative only, as there are often many competing additional factors which may influence claims volatility for the scheme.

In summary, other PII markets in Australia tend to allow choice of provider. This provides some evidence that competition can be effective but drawing a neat conclusion is complicated by the nuances in each market. Barristers have a choice of providers in NSW but face different risks. Health professionals have a choice of providers, but there is significant government intervention. Accountants have a choice of providers, but schemes are organised through professional bodies. Engineers have a choice of providers, but premiums have grown strongly, and some have struggled to get insurance.

4.5 Conclusions

Findings from this chapter are used to inform the scenarios that are presented in Chapters 5 and 6. The main findings from previous studies, analysis of the market and evidence from other markets are that:

- Economic theory would suggest that greater competition in the market for solicitors' PII would lead to lower premiums and better quality services.
- A previous AG's Department Review in 1999 recommended that the market be deregulated, and subject to certain conditions and a maximum of three players, solicitors in NSW be able to choose their insurer.
- There are several aspects of the market for solicitors' PII that make it distinct from a standard market – the product is designed to protect solicitors' customers, it is mandated, can work as a form of regulation (but may do this best when provided by a professional body), and generates data that may assist with risk management programs.
- Other solicitors' PII markets in Australia also have single-provider arrangements, namely, Lawcover itself, similar bodies, or a statutory body in Victoria.
- The solicitors' PII market in England and Wales is a multi-provider market, and has higher, more volatile premiums than NSW and there are reports of solicitors struggling to get insurance.

- Other PII markets in Australia tend to allow choice of provider. This provides some evidence that competition can be effective, but drawing a neat conclusion is complicated by the nuances in each market.

5 Scenario 2 analysis: ABC enters the market

5.1 Scope of the scenario analysis and interpretation

In line with the Scope of Work, the scenario analysis seeks to examine the anticipated effects under different scenarios including:

- (Scenario 1) the current state where the AG does not approve the proposed PII policy;
- (Scenario 2) the AG approves the proposed PII policy from ABC; and
- (Scenario 3) the AG approves additional policies.

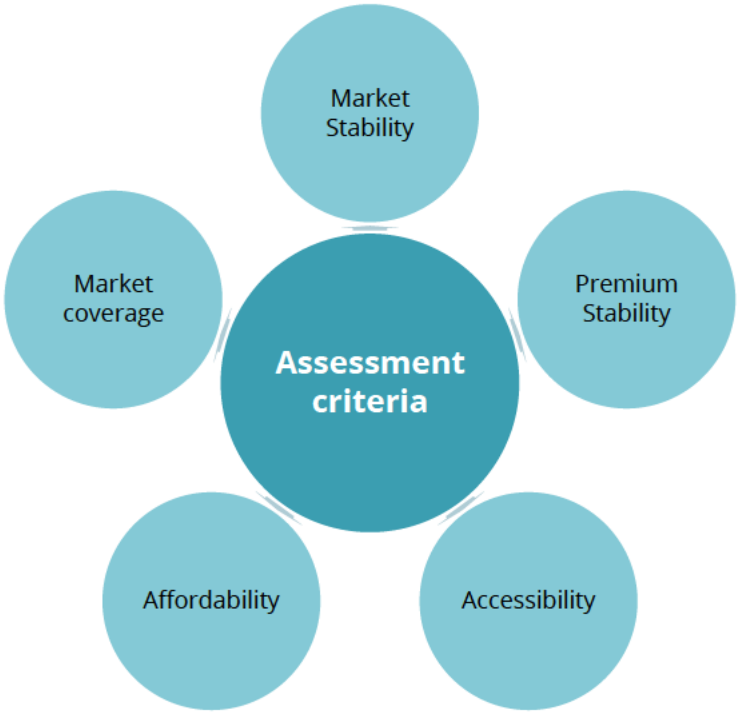
The analysis focuses on a comparison of findings for scenarios (2) and (3) relative to the baseline established (1).

The scenarios do not seek to perfectly predict future outcomes (which are inherently unpredictable). Further, this report's findings are further limited by incomplete data about how the current market operates. Recognising these limitations, the scenario analysis seeks to describe possible outcomes that could arise informed by:

- Data, both publicly available and from various other sources including Lawcover, other insurers, and the Department;
- Deloitte's understanding of insurance market dynamics and actuarial best practice, informed by analysis of comparable markets; and
- Economic theory.

Each of the scenarios are assessed based against the criteria outlined in Figure 2. This is a summary of the criteria provided by the Department.

Figure 5.1 Assessment criteria.



Source: Deloitte.

5.2 Overview of options considered under Scenario 2

An unknown that may significantly influence the impact of Scenario 2 on the assessment criteria is the strategy of the new market entrant. To reflect this uncertainty, Deloitte has developed two potential strategies, termed Option A and Option B, where the new provider either has an explicit strategy of trying to target lower risk market segments, or instead tries to serve the whole market. While neither of these strategies may be pursed in its pure form, these options help demonstrate the different potential impacts on the criteria under Scenario 2.

- Scenario 2A: ABC targets perceived lower risk market segments.
- Scenario 2B: ABC does not target specific market segments.

Under Scenario 2A, there is a single new market entrant, and the market operates as a duopoly, with ABC and Lawcover being the active participants. Here, ABC aims to target lower risk firms, focusing on firms in less risky areas of practise, and seeks to offer lower premiums to firms it is targeting.

Conversely, under Scenario 2B, there is again a single new market entrant while the market operates as a duopoly, with ABC and Lawcover as the active participants. However, here ABC does not directly target market segments, and instead aims to maximise market share across all market segments.

The case of multiple new entrants to the solicitors' PII market is presented separately in Chapter 6.

5.3 Scenario 2A: ABC targets firms in less risky areas of practice

Option A envisages a scenario under which ABC enters the market but actively focuses on marketing itself to firms in less risky areas of practise (e.g. areas other than conveyancing) or at least those firms it believes are lower risk relative to the premiums they pay. This reduces its exposure to law firms whose claims may be relatively high in comparison to the premiums charged by ABC, while also reducing the scope for volatility in claims experience.

Interestingly, analysis of Lawcover loss ratios by Finity finds that the degree of cross subsidisation across GFI bands is relatively small (a point also noted in Victoria in discussions with the LPLC).

Indeed, it is mid-sized firms for whom loss ratios are lowest, while they were highest in the last five years for some large sized firms.

It is not suggested that ABC would not provide insurance to firms operating in higher risk practice areas (ABC has indicated it will offer insurance to all firms), but rather for the purposes of this scenario that its marketing and pricing strategy could seek to focus on firms who focus predominantly on lower risk practise areas.

Importantly, information asymmetries mean that ABC is unlikely to have perfect information on the risk management processes of potential clients. Therefore, even if ABC targets what it perceives as lower risk market segments, it is unlikely to do so perfectly.

It is assumed that for ABC to win business, ABC will need to provide a material reduction on the premiums currently charged by Lawcover. This reduction is required as Lawcover has advantages as the market incumbent, namely that empirical evidence suggests some consumers can be resistant to change unless sufficiently incentivised. Also, non-price factors will influence consumer decisions, with firms' previous experience of the service provided by Lawcover potentially affecting their choices, while some firms may also be comforted by the fact that Lawcover is owned by the Law Society.

For the purposes of the modelling undertaken, it is assumed that initially ABC would need to offer a premium that is at least 10% below that of Lawcover to win over some law firms. Even so, it is not assumed that all firms would shift to ABC to receive a reduction in premiums. In the ACT, where Gallagher previously operated in competition with Lawcover, Gallagher held a market share of less than 40%.[34]

5.3.1 Impact on affordability

It is assumed that in the short term i.e. year 1 and 2, ABC would reduce its prices to grow its market share. However, after the first two years ABC may choose to revise prices to reflect:

- The claims experience of the firms who switch to ABC;
- The broader claims experience; and
- To achieve a sustainable profit margin in the longer term.

Premium analysis

Deloitte has analysed the potential impact of each option on each component of premiums in both the short and the long term. Deloitte's analysis considers the following components of a solicitors' PII premium:

- Claims costs, including the expenses incurred when managing claims;
- Acquisition function expenses;
- Administration function expenses;
- Expenses, associated with implementing risk management incentives;
- Net reinsurance cost;
- Investment returns, earned on premiums received prior to the payment of claims; and
- Net profit loading.

Due to limited data about existing operations, this analysis is based on a combination of publicly available statistics from APRA and Lawcover's annual reports, supplemented by actuarial judgement to estimate the current market premium components for Lawcover per $100 of claims. Deloitte used this current market position as the baseline for Deloitte's analysis. Lawcover's baseline position is outlined in Table 5.1 below.

Investment income is generated from net cashflows produced by underwriting until claims are paid out, effectively reducing the cost of insurance. A net profit margin compensates shareholders for

[34] Lawcover 2024, 'ACT scheme information'.

using their capital to support underwriting insurance risks. Since the Law Society is Lawcover's sole shareholder and is not driven by profit maximisation, and considering Lawcover has operated at an underwriting loss in recent years, Deloitte assume they do not include a net profit margin in their pricing.

The assumptions and sources of the information used to set the baseline position can be found in Appendix F: This baseline premium is expressed relative to a claims experience of 100. In the baseline, for each $100 of claims experienced, the total insurance cost and premium cost is $139.8.

Table 5.1: Lawcover baseline premium position

Component of premium	Baseline
	Lawcover
Claims Experience	100.0
Claims Management	7.0
Total claims costs	**107.0**
Acquisition Function	0.0
Administrative Function (General)	26.5
Risk Management Expense	1.2
Reinsurance	16.1
Investment Returns	(11.0)
Total Insurance cost	**139.8**
Net Profit Loading	0.0
Total premium cost	**139.8**

Source: Deloitte

Deloitte's assessment evaluates how each premium component would shift relative to this baseline for Lawcover in both the short and long terms, as well as for ABC/other entrants as they enter the market and progress into the long term.

5.3.2 ABC's pricing strategy

To reduce premium rates, Deloitte would expect ABC to use the following components of premium as levers to gain a competitive advantage over Lawcover in the initial market entry period:

- Claims experience
- Expenses (Administration and claims handling)
- Net profit loading.

Short term (1- 2 years)

Given in this Option ABC targets the more favourable risks, Deloitte assume that for a given level of cover, they would experience improved claims costs.

Lawcover's current portfolio applies cross subsidies of approximately 3% of the total portfolio target premium.[35] Finity's analysis of cross subsidies in Lawcovers portfolio shows that medium sized firms ($0.5m - $5.0m annual GFI) currently pay premiums above their risk level to cross subsidise smaller and larger firms. The analysis indicates that some firms ($2.0m - $5.0m of GFI) may be paying rates up to 10% higher than their risk level. Deloitte expect ABC to target this cohort of firms.

[35] Finity 2024, Provided Data.

While ABC could seek to target this cohort of firms, it is likely to have to target a broader set of firms to achieve a sustainable market share. It is also likely that it may not be able to perfectly target lower risk firms for a given GFI. Given these reasons, Deloitte believe the maximum improvement of claims experience relative to premium that ABC will be able to achieve will be 5%.

In the analysis, Deloitte assume that ABC will be effective in targeting risks and be able to achieve the maximum 5% improvement in claims experience relative to the baseline position. Deloitte has also assumed that Lawcover's remaining portfolio's experience will deteriorate by 5%, which will likely overstate the negative impact.

Deloitte expect expenses to vary between the two insurers. APRA statistics for commercial companies selling indemnity business indicate that Lawcover's current expenses are on the higher end of the industry norm. Deloitte's analysis indicates that an average competitive PII provider may operate at a level that is 35% more efficient than Lawcover. Interestingly, administrative costs as a share of claims are considerably lower for LPLC, and similar to the norm for commercial insurers, while the lower administrative costs of LPLC relative to Lawcover have also been noted elsewhere.[36] However, it should be noted that Lexon in Queensland has administrative costs that are similar to, and in some recent years slightly higher, than Lawcover.

In the long term (that is 5 years after market entry and beyond), Deloitte would expect ABC to operate at this average level of efficiency for commercial insurers. However, given a likely lack of economics of scale at the time of market entry, Deloitte has assumed ABC will be only 10% more efficient than Lawcover in the short term.

ABC will need to increase marketing costs from the baseline position as they enter the market with an established provider as their competitor. Deloitte expect ABC to adopt a more aggressive approach to marketing due to being the new entrant and Lawcover's presence as an established provider in the solicitors' PII market. The scenario also includes a modest amount for marketing by Lawcover.

Regarding risk management practices, Deloitte's scenario analysis is based on evidence to date. Lawcover's current risk management framework has seen most benefit from the responsive activities that focus on improving results for firms with poor claims experience. Given the historic return Lawcover has seen from this investment, Deloitte expects this to continue. The scenario also includes ABC investing in such activities. However, given ABC will be targeting firms with favourable claims experience, Deloitte expect ABC will incur lower costs for these incentives.

[36] PWC 2004, 'NCP Review of Legal Practitioners Bill'.

Net profit loading is the main component that ABC will have control over in the short term. It is possible that ABC will be willing to enter the market by setting premiums at a loss to gain market share within its target market. Under these circumstances, for ABC to set premiums at a level that is 10% below Lawcover's, they would require a modest negative profit loading of 1% of total insurance cost.

Table 5.2: shows the short-term pricing outcomes. For an original claims experience of $100, ABC's total premium cost in the short term is $132.50 compared to $147.20 for Lawcover. Lawcover's total premium cost of $147.20, which is above its baseline price of $139.80, reflects both worsening claims experience and additional customer acquisition costs.

Table 5.2: Scenario 2A ABC short term pricing strategy

Component of premium	Baseline	Short term	
	Lawcover	**LawCover**	**ABC**
Claims Experience	100.0	105.0	95.0
Claims Management	7.0	7.4	6.0
Total claims costs	**107.0**	**112.4**	**101.0**
Acquisition Function	0.0	2.0	5.0
Administrative Function (General)	26.5	26.5	21.7
Risk Management Expense	1.2	1.2	0.6
Reinsurance	16.1	16.1	16.1
Investment Returns	(11.0)	(11.0)	(11.0)
Total Insurance cost	**139.8**	**147.2**	**133.5**
Net Profit Loading	0.0	0.0	(1.0)
Total premium cost	**139.8**	**147.2**	**132.5**
% Change from baseline	**-**	**5.3%**	**(5.3%)**

Source: Deloitte.

Long term (5+ years)

It is likely that large discounts to current Lawcover premiums may not be sustained over time, particularly as ABC starts to experience growth in claims. It is anticipated that from year 3 premiums will begin to be adjusted upwards, reaching a more stable point at around 5 years. Deloitte assume that ABC will apply a profit loading of 10%.

As ABC gain an increased market share, Deloitte expect ABC to achieve further efficiencies and operate at an expense level that is in line with market average of commercial insurers underwriting long tailed lines of business. Lawcover will also experience efficiencies as they adapt to a competitive environment.

Table 5.3: Scenario 2A ABC long term pricing strategy

Component of premium	Baseline	Long term	
	Lawcover	**LawCover**	**ABC**
Claims Experience	100.0	105.0	95.0
Claims Management	7.0	7.0	6.0
Total claims costs	**107.0**	**112.0**	**101.0**

Acquisition Function	0.0	3.0	5.0
Administrative Function (General)	26.5	23.8	17.0
Risk Management Expense	1.2	1.2	0.6
Reinsurance	16.1	16.1	16.1
Investment Returns	(11.0)	(11.0)	(11.0)
Total Insurance cost	**139.8**	**145.1**	**128.7**
Net Profit Loading	0.0	0.0	12.9
Total premium cost	**139.8**	**145.1**	**141.6**
% Change from baseline	**-**	**3.8%**	**1.3%**

Source: Deloitte.

Deloitte's baseline analysis in Table 5.3: shows a slight increase in premiums relative to the baseline in the long term, with ABC's premiums being 1.3% higher and Lawcover's being 3.8% higher. This assumes a moderate reduction in administrative costs for ABC, and relatively modest acquisition costs.

Sensitivity Analysis

Deloitte assessed the expense efficiencies ABC needs to achieve to set premiums at Lawcover's baseline level. This assessment aims for a profit loading of:

- 10% – Considered the lower end of a reasonable range.
- 7% – The minimum profit loading expected for commercial insurers to remain in the market.

Table 5.4: Sensitivity analysis of ABC's expense efficiency levels

ABC Action	ABC Premium	Profit	Expense efficiency
Match Lawcover baseline	$139.8	10%	45-50%
Match Lawcover baseline	$139.8	7%	30-35%

Claim experience is a vital assumption in the above analysis, and will greatly depend on ABC's ability to target favourable risks, as well as how claim experience shifts in the future for targeted cohorts. The below Table 5.4 outlines how sensitive ABC's total premium is to these assumptions:

Table 5.5: Sensitivity analysis of ABC's ability to improve claims experience by targeting risks

Claims Experience Improvement	Premium cost
0%	147.4
3%	143.9
5% (assumed)	**141.6**
7%	139.3

Source: Deloitte.

What this shows is that to achieve premiums lower than Lawcover's baseline premium, ABC would need to target risks to improve claims experience by 7%. Given the low level of cross subsidisation in the baseline portfolio, this is unlikely to be achievable.

5.3.3 Lawcover pricing response

The analysis above considers Lawcover's average premiums, and does not assume that Lawcover acts in a strategic way to ABC pricing decisions. Below is a discussion of what could happen.

Economic theory suggests that incumbents who typically hold more capital can act strategically and choose to price below a new competitor to maintain their market dominance. Whether Lawcover would choose to do this is unclear. Doing so on a sustained basis could undermine Lawcover's financial position and it's not clear that the Law Society would bear such a risk, particularly given that it is likely to find itself paying more for marketing expenses. It is also possible that Lawcover may choose to discount strategically – offering premium discounts to firms with a strong claims history (information that is unlikely to be as well known to ABC).

Over time, Lawcover may choose to price more competitively for firms that are either clients of ABC or likely targets. These discounts may be offset by higher prices for Lawcover clients who are smaller or operating in higher risk practise areas, who are unlikely to be targeted by ABC. Such a strategy would maintain Lawcover profitability, while also ensuring Lawcover has competitive premiums for larger firms.

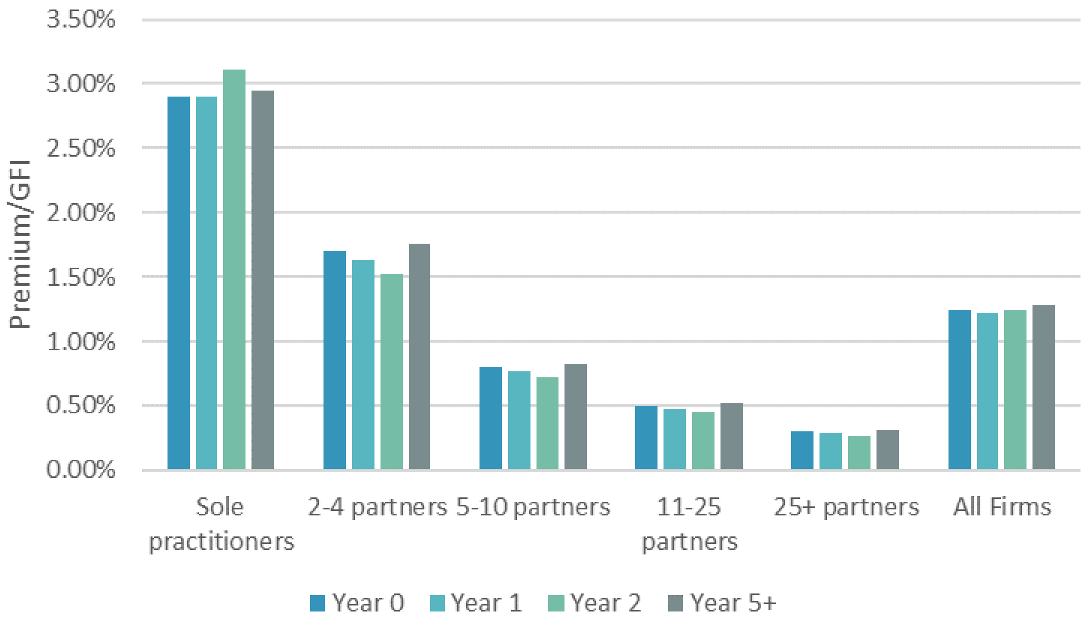
How could premiums evolve for firms that are not targeted by ABC?

As noted above, it is possible that Lawcover could choose to match ABC's pricing for those firms targeted by ABC and increase premiums for the remaining firms. This would impact affordability for firms not targeted by ABC. To explore the potential impact on premiums for these firms, Deloitte has analysed the impact of scenario 2A on different law firm sizes based on the premium per GFI charged to each firm size. Deloitte's analysis uses Lawcover-provided premium/GFI figures per practice size alongside estimates of current market share. In the analysis, Deloitte assume that Lawcover take the following actions in response to the changing market at each of the time intervals:

- Year 1: Lawcover maintains its current premium/GFI % for each practice size, reducing the overall premium pool charged across the scheme.
- Year 2: Lawcover matches new entrants' premium/GFI % for targeted practices to try and maintain business levels for these cohorts. It will increase the premium for other non-targeted cohorts to maintain the total scheme premium pool at current market levels.
- Year 5+: Lawcover continues with the strategy adopted in year 2 and match new entrants premium/GFI % for targeted practices. Lawcover increases the premium for other non-targeted cohorts to an increased premium pool level as implied by Deloitte's premium analysis.

Figure 5.2 outlines the variation in premiums across the market over the short and long term.

Figure 5.2 Impact on premium per practice size over the long and short term under a scenario where Lawcover matches ABC pricing for firms with 2 or more partners in year 2 onwards.



Source: Deloitte.

In the short term, Deloitte expect premium/GFI to reduce for targeted firms by approximately 10%. Non-targeted firms are likely to experience an increase in premium/GFI of approximately 7%.

In summary, the evidence suggests that in the longer term, there will be upward pressure on premiums even if ABC is able to achieve relatively large efficiencies in administrative costs. This arises due to the need for a profit margin and higher acquisition costs. Nevertheless, the increase in long term premiums is expected to be relatively modest. It is theoretically possible for overall premiums to fall, but this would require a very large reduction in administrative costs.

There may be some variation in premium changes across the market in the short term and Lawcover may choose to respond by competing on price for firms ABC is targeting while recovering more from non-targeted firms. However, in the longer term, as ABC adjusts premium prices to a sustainable level, this could see Lawcover ease premiums on non-targeted firms.

The analysis here considers average premiums for two insurers and is underpinned by a number of assumptions. In practice premium outcomes could vary considerably by firm in the short term and long-term, reflecting both existing price dispersion and how insurers respond when determining premiums for individual firms. Thus, at a firm level, there may be greater variability in premiums than is shown in average premiums or average premiums for a given GFI band.

5.3.4 Impact on premium stability

While the analysis above illustrates the short and long term effect on premium levels resulting from the introduction of ABC as a new market entrant, the evaluation criteria established by the Department also places value on premium *stability*, as this allows solicitor firms to better budget for insurance costs over time.

As the analysis above demonstrates, in the short-term in Scenario 2, it is expected that premiums will decrease for select targeted firms but increase for other non-targeted firms. However overall, the variance is relatively minimal, with stability in premiums preserved.

How might premiums vary in the long term, as the insurance market goes through cycles?

Under Scenario 1, representing the status quo, Deloitte understand that Lawcover might be expected to continue to use its capital reserves to smooth out fluctuations. However, under Scenario 2, it is possible that a commercial insurance business is more likely to let premiums vary, reflecting economic or insurance market conditions. This would imply that premiums will be less stable under Scenario 2.

Further to this, comparator evidence gathered from the UK (Appendix C) suggests that for solicitors' PII, the market in England and Wales exhibits greater price variability relative to the Australian market. While Scenario 2 involves just two firms (and the England and Wales market is characterised by multiple firms), Deloitte has not seen evidence that competition improves premium stability.

Finally, as noted in Chapter 4, there is historical evidence of both Victoria and Northern Territory experiencing large and sustained premium increases when reliant on commercial insurers under a master policy to provide solicitors' PII. This suggests that, on balance, premiums are likely to be less stable in Scenario 2.

5.3.5 Impact on accessibility, market coverage and stability

By design, Lawcover's premiums under the status quo (Scenario 1) are generally affordable. Under Scenario 2, Lawcover's premiums rise by over 5% in the short term, and are almost 4% higher in the long term, purely from having a riskier profile of customers (and some marketing costs, partially offset by lower administration costs). ABC's prices are lower than Scenario 1 in the short term, but rise to just over 1% higher in the long term.

Would these pricing adjustments dramatically affect accessibility, market coverage and stability? In Deloitte's assessment that is unlikely. To put it in context, a 5% price increase on 3% of GFI premium would be $150 a year – unlikely to be the difference between remaining in business and shutting down.

Of course, there could be some impacts at the margin, perhaps not for cohorts of firms, but for those who experience adverse claims events. They could face higher premiums, or a situation where either provider may be less willing to provide PII. Another complexity would arise if Lawcover changed its pricing strategy and reduced cross-subsidisation, which could also affect certain firms. There may also be challenges in securing universal affordable coverage in the longer term.

Additionally, the entry of a new provider has the potential to create a different dynamic in the market. As a for-profit insurer, it is also possible that ABC may be less willing to absorb fluctuations in the global insurance market than Lawcover which may lead to greater premium variability. There is also a greater risk that either ABC or Lawcover may choose to exit the market. While the ACT operated with two providers for some time, the exit of Liberty just before the renewal of premiums resulted in a degree of disruption for market participants.

Of particular interest to this review is the impact on more vulnerable members of the public including low-income individuals, new migrants, those from culturally and racially marginalised groups, and those residing in rural and remote areas. These groups may be more likely to seek services from small law firms, including firms with a sole practitioner, for practice areas including conveyancing (which tends to have a greater likelihood of claims). While premium increases on small firms are expected to be relatively moderate, it is likely to be the case that small firms may also have greater difficulty absorbing any fee increases. While the departure of a few firms may affect some vulnerable consumers, importantly Community Legal Centres typically adopt a different scheme for PII. While Lawcover does offer cover to some Community Legal Centres (and could choose to rescind that cover in a competitive market), relatively few centres are covered by Lawcover. Thus, the overall impact on vulnerable members of the public is expected to be modest.

5.3.6 Impact on risk management

Risk management activities could be affected by the entry of a new player, ABC. The most costly situation would be if insurance companies reduced, ceased or did not undertake risk management activities because they may incur the cost of such activities (helping a business one year), but not receive benefits (in terms of lower claims) the following year because businesses could switch providers.

There are some reasons why this situation may not occur. Analysis of Lawcover's risk management activities (costing $1 million in 2021-22) finds that the benefits flow not just to the industry and businesses, but also through reduced claims costs to Lawcover by $1.1-$4.1 million. Therefore, it will make sense for Lawcover (and indeed, other players including a new entrant) to provide these services. The greatest benefits come from the direct response programs rather than the general industry education programs.

The risk of those receiving risk management intervention then switching providers seems unlikely because they will have a higher claims history.

It is possible the more general risk mitigation education programs do not reach a competitors' client base, but the impact of these activities is lower (and could be as low as $0). These activities could be undertaken as part of professional standards and done by the Law Society.

5.3.7 Impact on consumers of NSW law firms

There are a range of potential price and non-price impacts on consumers, the household and business customers of law firms.

Price impacts on consumers will primarily depend on the degree to which changes in premiums flow through to the fees or hourly rates paid by consumers as customers of law firms. This will depend on the level of competition and the capacity of law firms to absorb increases in costs. There are a large number of law firms in NSW, so competition is assumed to be healthy. In the short term, one might expect some of the lower prices paid by ABC's customers and some of the higher prices paid by Lawcover customers to be passed on to consumers, but the actual changes are small. In the long term, price changes are expected to be higher than under Scenario 1, but again, the amounts are very small.

Another potential impact is that a customer may have to change provider, either because PII costs have increased too much (unlikely) or because they cannot get cover (possible for some higher-risk firms or those in higher-risk practice areas).

5.3.8 Adequacy of PII cover including run off cover

[redacted] As noted previously, Lawcover's policy does not have a minimum run off period. It is likely that sufficient coverage will be provided under scenario 2A.

5.4 Scenario 2B: ABC targets all law firms

Under Scenario 2B, ABC enters the market but does not actively target any specific market segments, instead focusing on maximising its market share across all solicitor firms. Here, ABC's marketing and pricing strategies would operate agnostic of risk-based characteristics, with the expectation that ABC will aim to undercut Lawcover prices for all firms operating in the market.

This means that the expected claims experience of ABC does not materially differ from that of Lawcover. Similar, to Scenario 2A, it is assumed that ABC will offer a material reduction on the premiums currently charged by Lawcover to win business. Again, firms that have had a good experience with Lawcover (or because it is owned by the Law Society) may stay with their supplier regardless. For the purposes of the modelling it is assumed that initially ABC would need to offer a premium that is at least 10% below that of Lawcover to win over some law firms. Even so it is not assumed that all firms would shift to ABC to receive a reduction in premiums.

5.4.1 Impact on affordability

In the short-term impacts to affordability would be positive for market participants opting to switch to ABC, as ABC will seek to set prices below the level at which they believe Lawcover would charge in order to gain market share.

However, in the long term, and particularly as ABC gathers evidence of the claims brought by high risk firms, ABC may opt to become more selective in its pricing. This could see premiums for certain firms revised to reflect:

- The claims experience of the firms who switch to ABC;
- The broader claims experience; and
- To achieve a sustainable profit margin in the longer term.

Under Scenario 2B, this process is less likely to result in a material impact to affordability, as ABC does not explicitly target low risk market segments, and so any risk-based market segregation will take longer to feed through to the wider market. However, premium affordability for certain market segments remains a material long-term prospect.

Premium Analysis

Under this scenario, ABC is targeting firms irrespective of risk-based characteristics. Deloitte therefore assume that claim experience will be distributed evenly between both firms. ABC will continue to aim to adjust the other two levers of premiums as used in Scenario 2A, to undercut Lawcover's rates and gain market share. These are:

- Expenses (Administration and claims management)
- Net profit loading

Deloitte assume the same level of efficiency will be achieved by ABC in Scenario 2B as in Scenario 2A. That is, ABC will be 10% more efficient than Lawcover in the short term with regard their administration and claims management expenses.

Under the assumption that both entities continue to provide risk management incentives, Deloitte expect that the cost will be similar between Lawcover and ABC as they will both have the same proportion of higher risk firms in their portfolio requiring risk management interventions.

Under this scenario, for ABC to undercut Lawcover's rates by 10%, they would be required to set a negative profit loading of 9% to the total cost of insurance. This compares to a 1% negative profit loading in Scenario 2A.

All other assumptions regarding the components of premium in this analysis are consistent with Scenario 2A and can be found in Appendix F:.

Table 5.6: Scenario B ABC's short term pricing strategy

Component of premium	Baseline	Short term	
	Lawcover	**LawCover**	**ABC**
Claims Experience	100.0	100.0	100.0
Claims Management	7.0	7.0	6.3
Total claims costs	**107.0**	**107.0**	**106.3**
Acquisition Function	0.0	2.0	5.0
Administrative Function (General)	26.5	26.5	21.7
Risk Management Expense	1.2	1.2	1.2
Reinsurance	16.1	16.1	16.1
Investment Returns	(11.0)	(11.0)	(11.0)
Total Insurance cost	**139.8**	**141.8**	**139.4**
Net Profit Loading	0.0	0.0	(12.0)
Total premium cost	**139.8**	**141.8**	**127.4**
% Change from baseline	**-**	**1.4%**	**(8.9%)**

Source: Deloitte.

In the long term, ABC will aim to move to make an acceptable rate of return, a profit. Deloitte assume they will implement a profit loading of 10%, which Deloitte consider to be on the lower end of acceptable return targets based on APRA data and typical return expectations for commercial insurers.

In line with scenario A, Deloitte assume both firms experience expense efficiencies with ABC moving to a level of efficiency that is in line with commercial insurers of this nature, that is, 35% more efficient than Lawcover's baseline position.

Table 5.6 outlines ABC's long term pricing strategy in comparison to Lawcover's long term estimate and current baseline position.

Table 5.7: Scenario B ABC's long term pricing strategy

Component of premium	Baseline	Long term	
	Lawcover	**LawCover**	**ABC**
Claims Experience	100.0	100.0	100.0
Claims Management	7.0	6.7	6.0
Total claims costs	**107.0**	**106.7**	**106.0**
Acquisition Function	0.0	3.0	5.0
Administrative Function (General)	26.5	23.8	17.0
Risk Management Expense	1.2	1.2	1.2
Reinsurance	16.1	16.9	16.9
Investment Returns	(11.0)	(11.0)	(11.0)
Total Insurance cost	**139.8**	**140.6**	**135.1**
Net Profit Loading	0.0	0.0	13.5
Total premium cost	**139.8**	**140.6**	**148.6**
% Change from baseline	**-**	**0.6%**	**6.3%**

Source: Deloitte.

Under these assumed conditions, ABC will be unable to set premiums at a competitive level while achieving an acceptable return on their investment in the long run. ABC would not be able to gain sufficient market share and would likely exit the market.

Sensitivity Analysis

Deloitte assessed the expense efficiencies ABC needs to achieve to set premiums at Lawcover's baseline and long-term levels. This assessment aims for a profit loading of:

- 10% – Considered the lower end of a reasonable range.
- 7% – The minimum profit loading expected for commercial insurers to remain in the market.

Table 5.8: Sensitivity analysis of ABC's expense efficiency levels

ABC Action	ABC Premium	Profit	Expense Efficiency
Match Lawcover long term premium	$140.6	10%	65-70%
Match Lawcover baseline	$139.8	10%	65-70%
Match Lawcover baseline	$139.8	7%	50-55%

5.4.2 Impact on premium stability

The impact of the entry of a commercial insurer on premium stability is expected to be similar to Scenario 2A. The only potential difference is that in a scenario where ABC is not targeting lower risk firms there may be slightly greater variability in claims experienced.

5.4.3 Impact on accessibility, market coverage and stability

In terms of accessibility and market coverage, it is again expected that PII accessibility would not be compromised given Lawcover should continue to generate acceptable returns with the appropriate price changes. Similar to the conditions exhibited under Scenario 2A, Lawcover's premiums will rise slightly in response to adverse claims experiences in the past, but premiums would generally remain affordable without exhibiting significant increases. Additionally, ABC's stated commitment to offer insurance coverage to all applicants would again suggest that the present coverage of PII will remain intact.

However, it is again less clear how ABC premiums might change if a firm were to experience an adverse claims event, with this situation potentially resulting in an increase to premiums. In this scenario, the firm in question could seek to return to Lawcover, but would be required to pay the marginally higher Lawcover premium. However, it is again relevant to note that Lawcover has indicated that it may need to reassess its strategy if ABC were to enter the market.

In the long term, Lawcover may be less willing to subsidise certain less profitable firms in a competitive market, particularly given that this circumstance would see Lawcover's capacity to implement adequate risk spreading constrained. As such, Lawcover may choose to cease offering cover to higher-risk solicitor firms. Consequently, this suggests that there could be challenges in securing universal affordable coverage in the longer term for some firms. However, it should be noted that it is difficult to speculate at this stage.

5.4.4 Impact on risk management

Under similar conditions to those described in relation to Scenario 2A, the effectiveness of the risk management procedures adopted across the solicitors' PII market could be affected by the entry of ABC as an additional market participant. As a profit-driven entity, ABC may opt to reduce or even cease entirely the provision of risk management programmes or the monitoring of risk-associated behaviours in order to reap short term financial benefits. If this situation were to occur, it could result in a single year financial gain to ABC, given the cost associated with actioning such activities. However, this would be expected to lead to negative cost implications in future years as the risk of greater claims would increase.

As with Option A, there are reasons to believe that this may not occur, as the evidence concerning the costs and benefits of Lawcover's risk management activities remains relevant. To restate, the risk management processes currently in place were found to cost Lawcover $1 million in 2021-22, but resulted in reduced claims costs to Lawcover of $1.1-$4.1 million. These benefits are understood to mostly come from the direct response programmes as opposed to the general industry education program, and given their positive influence there are grounds to believe that they could be provided by ABC. The more general risk mitigation education programs are understood to have a lower impact, while these activities could reasonably be undertaken as part of professional standards and remain overseen by the Law Society. Further to this, the evidence that undertaking risk management activities could be mandated remains pertinent.[37] Importantly, Gallagher/Liberty in the ACT previously provided risk management services to their clients.

5.4.5 Impact on consumers of NSW law firms

The potential impacts to consumers are similar to those expressed in the analysis of Scenario 2A, covering a range of potential price and non-price impacts. In terms of the price impacts, again assuming a competitive market provides consumers with a degree of pricing power, the short-term

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37 APRA 2024, APRA Mandates Risk Remediation Program for Auto & General Following Risk Governance Concerns, <http://www.apra.gov.au/news-and-publications/apra-mandates-risk-remediation-program-for-auto-general-following-risk>.

price discount offered by ABC may be passed on to consumers in part, although the changes are not material. In the long term, price changes are also small, although it is notable that Lawcover premiums are expected to be lower than those of ABC, and those found under Scenario 2A.

5.4.6 Adequacy of PII cover including run off cover

[redacted] As noted previously, Lawcover's policy does not have a minimum run off period. It is therefore expected that sufficient run off will be provided under scenario 2B.

5.5 Scenario 2 summary

The table summaries the outcomes by assessment criteria.

Scenario outcomes by assessment criteria

	Premium Stability	Affordability	Accessibility, market coverage, and stability	Risk management	Consumers	Run-off cover
Scenario 2a	Minimal variance in aggregate premiums, with risks of increased premium variability more prevalent for higher risk firms.	Changes in premiums are marginal, with decreases in the short term and an estimated increase in the long term of up to 4%.	Market coverage is likely to be preserved but there may be some small adverse effects if high risk firms struggle to obtain insurance at a reasonable price.	Risk of decreased investment in risk management partially mitigated by demonstrated success of programmes.	Short and long term changes in premiums may be passed on to consumers, but impacts are minimal.	It is likely that sufficient coverage will be provided, as [redacted]
Scenario 2b	Impacts similar to Scenario 2A.	Positive short-term impacts to affordability but long-term premiums estimated to increase by approximately 6% for ABC customers. This suggests there may be challenges to ABC's competitiveness in long run.	Risk of market disruption if ABC exits the market, however Lawcover should continue to provide full, accessible coverage.	Impacts similar to Scenario 2A.	Impacts similar to Scenario 2A, however there may be additional disruption to consumers if ABC exits the market.	Impacts similar to Scenario 2A.

6 Scenario 3 analysis: open market

6.1 Description of scenario

Scenario 3 is concerned with multiple new entrants to the solicitors' PII market, where there is an open market and firms actively compete for market share. Depending on the number of participants, this market may be characterised as either an oligopoly, in which providers retain some pricing power, or if enough participants enter, perfect competition, in which providers compete to the extent that pricing power is very limited.

Under these conditions, market entrants are unable to implement net risk targeting, meaning that new entrants are not able to select lower risks. Instead, all new entrants operate agnostic of risk-based characteristics but aim to undercut Lawcover prices for all solicitor firms operating in the market. Additionally, new entrants may not be well placed to assess the firms that are lower risk.

Similar to Scenario 2B, this means that the expected claims experience of the new entrants will not materially differ from that of Lawcover.

Again, as with Scenario 2, it is assumed that in order to win business, new entrants will need to provide a material reduction on the premiums (that is, at least 10%) below what is currently charged by existing market participants. Even so it is not assumed that all firms would shift to new market participants in response to this price reduction given Lawcover's advantage as the market incumbent.

For the purpose of the scenario modelling, it is assumed that a range of entrants enter the market at the same time to compete with Lawcover (as the existing market participant). That is, the scenario compares premiums for Lawcover relative to that of new entrants who are assumed to enter the market at the same time and compete with Lawcover. This scenario may be a simplification as in practice entrants may enter the market sequentially. So while the first entrant may need to offer a price reduction to win business from Lawcover, subsequent entrants may need to price at a level that is below that of existing market participants i.e. Lawcover and any existing entrants.

6.2 Impact on affordability

Similar to the conditions described under Scenario 2, Deloitte has considered the impact of the multiple entrants to the market on premiums in both the short and longer term. Here, the new entrants will prioritise market share and seek to price below the level at which they expect Lawcover and other competitors will charge. Again, given the advantages afforded to Lawcover as the incumbent, it is likely that a material price reduction is required for law firms to switch to the new entrants.

It is assumed that in the short term i.e. year 1 and 2, entrants will offer prices below the current level to grow their market share. However, after the first two years the new entrants may choose to revise prices to reflect:

- the claims experience of the firms who switch from Lawcover;
- the broader claims experience; and
- the aim to achieve a sustainable profit margin in the longer term.

6.2.1 Premium analysis

Similar to the analysis in Chapter 5, this Chapter analyses the potential impact on premium rates for firms in the NSW solicitors professional indemnity market by considering how the components of premiums will differ from the current market baseline position in the short and long term. This analysis is a continuation of the analysis carried out in Chapter 5 and uses the same assumptions to develop Lawcover's baseline position as outlined in Appendix F:

Deloitte has not defined the potential number of new market entrants. Instead, Deloitte has considered the likely average premium that will be offered across all new market entrants in an open market.

Short term (1- 2 years)

Deloitte does not expect new entrants to successfully be able to target lower risk firms on average relative to the premiums they pay. Deloitte therefore has assumed that the claims experience will be consistent with Lawcover's baseline position. Deloitte's assumption is based on:

- New entrants not having enough information on the market to be able to identify lower risks.
- Low levels of cross subsidisation in the baseline position.

Deloitte has therefore assumed that under this scenario, claim experience will be consistent between Lawcover and new entrants.

Deloitte does not expect new entrants to achieve the same level of efficiency in their expense functions as ABC would as a singular market entrant. Multiple entrants would split the market share between them, resulting in each insurer having a lower market share and therefore experiencing less economies of scale. Deloitte assumes that new entrants will incur similar costs to Lawcover in their claim management activities while experiencing some efficiencies in their administrative function.

In an open market, it is unlikely that firms will invest in risk management activities due to the heightened risk of firms switching providers, given the increased number of options available. Insurers are less likely to invest in risk management if they believe they will not experience the benefits of their investment should a firm move to a different provider in subsequent years. This logic also applies to Lawcover. Therefore, Deloitte assumes that neither Lawcover nor new entrants will continue to invest in risk management activities.

Insurers entering the market will need to spend a significant amount on acquisition costs to gain a market share in a scenario where there are multiple new entrants in the market. Deloitte expects that new entrants would need to spend double (per $ baseline claim) what ABC would be required to spend if they were to enter the market as a singular new entrant. This is driven by:

- New entrants needing to market sufficiently to stand out among numerous other new entrants.
- Less economies of scale by a market entrant in an open market than in a two-provider market.

Lawcover will also need to market more aggressively in an open market although not to the same extent as new market entrants. Deloitte expects Lawcover to increase spend on acquisition costs to a level that is in line with a commercial average.

Deloitte has assumed that net reinsurance costs and investment returns will be consistent between Lawcover and new entrants.

Deloitte continues to assume in this scenario that a new entrant would be required to undercut Lawcover's premium by at least 10% for firms to be willing to switch providers in the short term. Under Deloitte's assumptions, a new entrant would be required to sell contracts with an average negative profit loading of 10% of total insurance cost.

Table 6.1: Short term impact on premium components in an open market

Component of premium	Baseline	Short term	
	Lawcover	**Lawcover**	**New Entrants**
Claims Experience	100.0	100.0	100.0
Claims Management	7.0	7.0	7.0
Total claims costs	**107.0**	**107.0**	**107.0**
Acquisition Function	0.0	5.0	10.0
Administrative Function (General)	26.5	26.5	22.5
Risk Management Expense	1.2	0.0	0.0
Reinsurance	16.1	16.1	16.1
Investment Returns	(11.0)	(11.0)	(11.0)
Total Insurance cost	**139.8**	**143.6**	**144.6**
Net Profit Loading	0.0	0.0	(15.0)
Total premium cost	**139.8**	**143.6**	**129.6**
% Change from baseline	**-**	**2.7%**	**(7.3%)**

Source: Deloitte.

In the short term, a reduction in premiums is possible for firms that switch providers. If new entrants are willing to write policies with a substantial loss and can collectively win 30%+ market share, the overall average market premium will reduce in the short run.

Long term (5+ years)

Deloitte expect in the long term that the absence of risk management activities in the market will have a negative impact on the claims experience across the total market. Given Deloitte has assumed no net risk targeting will be achieved by new entrants Deloitte expect the unfavourable experience will be shared between all market participators.

Finity's most recent review of Lawcover's risk management framework indicates a potential impact of Lawcover's risk management incentives of between $1.1m - $4.1m. [38] Deloitte has taken the midpoint of these figures and scaled it to be per $100 of claims. Deloitte has allowed for this amount, $3.2, in the deterioration of claims experience in the long term under this scenario.

Deloitte expect the competitive environment will result in efficiencies in administration costs in the long run for both Lawcover and new entrants. However, the extent to which efficiencies can be achieved will be tempered by lower business volumes per insurer thereby lowering economies of scale. Deloitte assume new entrants to be 30% more efficient than Lawcover's baseline in the long run, which is below the commercial average efficiency improvement of 35% allowed for in scenario 2.

Lawcover may also need to increase their acquisition costs in the long term to maintain market share. It may also experience a loss of economies of scale which would adversely impact its acquisition cost per $100 baseline claims. New entrants would become more established in the market and would gain some economies of scale as they grow their market share. For this reason, Deloitte has assumed both Lawcover and new entrants have similar acquisition costs in the long term.

Sharing the market among multiple insurers will increase claims volatility for individual insurers from the baseline position. This increased claim volatility in conjunction with worsening claim experience

38 Finity Consulting 2021, *Review of Risk Management Impact*, for Lawcover.

across the market would impact access and cost of reinsurance. Deloitte has assumed that in the long term there will be a slight increase in net reinsurance cost.

For all other premium components that contribute to insurance cost, Deloitte have assumed these remain consistent with the short-term assumptions.

In the long term, new entrants will aim to move to a profit-making state. Deloitte assumes they will implement a profit loading of 10%, which Deloitte considers to be on the lower end of acceptable return targets.

Table 6.2: Long term impact on premium components in an open market

Component of premium	Baseline	Long term	
	Lawcover	LawCover	New Entrants
Claims Experience	100.0	103.2	103.2
Claims Management	7.0	6.5	6.5
Total claims costs	**107.0**	**109.7**	**109.7**
Acquisition Function	0.0	8.0	8.0
Administrative Function (General)	26.5	23.8	18.5
Risk Management Expense	1.2	0.0	0.0
Reinsurance	16.1	16.9	16.9
Investment Returns	(11.0)	(11.0)	(11.0)
Total Insurance cost	**139.8**	**147.4**	**142.2**
Net Profit Loading	0.0	0.0	14.2
Total premium cost	**139.8**	**147.4**	**156.4**
% Change from baseline	**-**	**5.5%**	**11.8%**

Source: Deloitte.

Under these assumed conditions, new entrants will be unable to set premiums at a competitive level while achieving an acceptable return on their investment in the long run. As shown in the table, new entrant premiums would be around 12% higher than in the baseline. They would not be able to gain sufficient market share and would likely exit the market. This could possibly lead to a natural selection of providers, with the most efficient insurers surviving over the long term.

Sensitivity Analysis

Deloitte assessed the expense efficiencies ABC needs to achieve to set premiums at Lawcover's baseline and long-term levels. This assessment aims for a profit loading of:

- 10% – Considered the lower end of a reasonable range.
- 7% – The minimum profit loading expected for commercial insurers to remain in the market.

Table 6.3: Sensitivity analysis of ABC's expense efficiency levels

ABC Action	ABC Premium	Profit	Expense Efficiency
Match Lawcover long term premium	$147.4	10%	40-45%
Match Lawcover baseline	$139.8	10%	70-75%
Match Lawcover baseline	$139.8	7%	60%

6.2.2 Impact on premium stability

While the analysis above illustrates the short and long term effect on premium levels resulting from a scenario where there are multiple new entrants in the market, the evaluation criteria established by the Department also places value on premium *stability*, as this allows solicitor firms to better budget for insurance costs over time.

As the analysis above demonstrates, in the short-term in Scenario 3, it is expected that premiums will decrease for firms that switch to new entrants, and increase for other firms who remain with Lawcover. However overall, the variance is relatively minimal, with stability in premiums preserved.

How might premiums vary in the long term, as the insurance market goes through cycles? Under the Scenario 1, the status quo, Deloitte understands that Lawcover might be expected to continue to use its capital reserves to smooth out fluctuations. However, under both of the scenarios considered, but particularly Scenario 3, it is possible that a commercial insurance business is more likely to let premiums vary, reflecting economic or insurance market conditions. This would imply that premium's will be less stable under Scenario 3 than the current state.

Further to this, comparator evidence gathered from the UK (Appendix C) suggests that for solicitors' PII, the market exhibits greater price variability relative to the Australian market. In the longer term, the evidence suggests that many new entrants are unlikely to be able to compete on price with Lawcover due to the need to obtain a sufficient profit margin. This may lead to some firms having to increase prices further to remain profitable as their market share declines. In a competitive market, premiums may also vary more in response to changes in claims experience. Collectively these factors imply a reduction in premium stability relative to Scenario 1 and 2.

6.2.3 Impact on accessibility, market coverage and stability

The effect of multiple market entrants on accessibility and market coverage is expected to be more significant than that exhibited under a single-entrant scenario. Here, there is a material risk that new entrants will adopt risk seeking behaviours to gain market share, and may exit the market if they are unsuccessful in attaining a significant portion of the market. In the short term, pricing competition between new entrants will drive premiums lower, meaning that if Lawcover is unresponsive it may struggle to retain market share, and will, at a minimum, be required to increase spending on acquisition costs. However, new entrants are assumed to accept significant losses on premiums, a strategy which is unsustainable in the longer term.

In the long term, the modelling suggests that new entrants will be unable to set premiums at a competitive level while achieving an acceptable return on their investment i.e., a 10% loading on insurance costs. This is likely to lead to increased market volatility, with an increased risk of insurance providers entering and exiting the market. Here, coverage and particularly accessibility would be negatively impacted as firms may find their provider opting to discontinue their coverage. Additionally, given the highly competitive nature of the market, new entrant premiums could be expected to exhibit greater variability in response to adverse claims events, resulting in an increase to premiums for high risk firms.

6.2.4 Impact on risk management

Under Scenario 3, it would be expected that market participants will have less incentive to invest in risk management activities. Although the evidence demonstrating that the benefits associated with Lawcover's risk management activities exceed the costs of implementing these processes remains relevant, aligning the motivations of multiple entrants to invest in continuing the current standard of risk management procedures is likely to be challenging.

Primarily, this difficulty relates to the co-ordination of best practise procedures. As each entrant providing PII coverage in the market will hold a diluted portion of market share relative to that held under Scenario 1 or 2, the richness of the firm level datasets available to test risk management processes will be poorer. Therefore, as firms naturally diverge in their risk management offerings, establishing the most effective solutions to emerging problems is likely to be more difficult.

Furthermore, with multiple market participants entering into strong competition to capture market share, the degree of switching exhibited by solicitor firms can be expected to increase substantially.

This behaviour decreases provider incentives to invest in risk management procedures as, if the benefits of undertaking such procedures are realised after the law firm in question has switched providers, then the downstream cost saving would be captured by a rival firm.

Under such a scenario, there may be value in pursuing a formalised and centralised approach to risk management co-ordination, which could alleviate the problems described. As discussed previously, general risk mitigation education programs could reasonably be undertaken as part of professional standards and remain overseen by the Law Society. However, as stated these programmes are commonly understood to have a lower impact than the direct response programmes targeting specific firms. For these, implementing a centralised approach to direct response programmes may face issues related to the allocation of the cost burden, as providers who hold a lower portion of solicitor firms requiring direct response intervention are unlikely to agree to contribute an equal share. Consequently, achieving a robust approach to risk management under a multiple entrant scenario presents a significant challenge.

6.2.5 Impact on consumers of NSW law firms

Scenario 3 is likely to lead to a small increase in premiums in the long term, some of which is likely to be passed on to consumers. A further challenge in Scenario 3 is that premiums are likely to be more variable and insurers are more likely to exit the market with little notice. This may impact the ability of firms to source PII and may lead to larger year on year revisions on premiums which are likely to flow to consumers. Firms that experience adverse claims events are likely to have greater difficulty securing affordable insurance in a competitive market and in some cases may need to exit the market. Such a circumstances would require consumers of these firms to seek alternative legal representation.

6.2.6 Adequacy of PII cover including run off cover

Under the Uniform Law a PII policy must provide cover for a period of seven years from the time of the run-off event. As noted previously, Lawcover's policy does not have a minimum run off period. On the basis that any approved policies will need to meet the requirements of the Uniform Law it is likely that sufficient run off cover will be available under Scenario 3.

6.3 Scenario summary

The tables summarises the outcomes of Scenario 3 against the assessment.

Scenario outcomes by assessment criteria.

	Premium Stability	Affordability	Accessibility, market coverage, and stability	Risk management	Consumers	Run-off cover
Scenario 3	Negative impacts to premium stability as commercial insurance business more likely to allow premiums to vary in line with economic or insurance market conditions.	Positive short-term impacts to affordability compromised in the long term by estimated premium increases of up to 12%.	Significant risk of market disruption as participants enter and exit the market, with follow on impacts to coverage and accessibility.	Lower incentives to invest in risk management, with difficulties in maintaining the quality of risk management programmes anticipated.	Long term increases in premiums are likely to be passed on to consumers, while premiums are likely to be more variable and insurers are more likely to exit the market with little notice.	As any approved policies will need to meet the requirements of the Uniform Law, it is likely that sufficient run off cover will be available.

Source: Deloitte

7 Potential mitigating structures

The scope of this report also encompasses providing advice on structures that could be put in place to mitigate risks that might arise if one or more new insurers were introduced to the NSW solicitors' PII market. The key risks that such structures would seek to mitigate include risks to:

- market stability
- premium stability, affordability and accessibility
- market coverage
- the overall effectiveness of the model.

This report does not seek to provide a detailed policy evaluation of potential risk mitigating structures or an exhaustive list of policy options. Rather, it seeks to discuss a set of potential options that may help mitigate some of the risks associated with opening up the market or extending it to one more entrant. Deloitte is not necessarily advocating the adoption of all of these options, but they may suggest potential policies approaches for the Department to consider.

The first policy option that will be important to mitigating potential risk is to ensure that once a policy has been assessed as meeting the requirements of the Uniform Law, insurers are not permitted to make further changes to the policy without consulting the Attorney General. This would help ensure that coverage is not reduced over time to the detriment of consumers. This option was contemplated in the 1999 Review, expressed as 'minimum standards' and appropriate provision of run-off cover.

The second policy option that could be considered to support premium stability, affordability and accessibility is to place a price cap on the maximum premium that could be charged. This would avoid a scenario where premiums become unaffordable, especially to those who have had claims in the past. Information provided by Lawcover indicates the maximum premium was approximately 4% of GFI currently. The Attorney General may choose to set a cap at this rate or slightly higher but at a level that still remained affordable in the market. This is a fairly significant intervention in the market, but it would help support affordability, especially for smaller firms. This option too was contemplated in the 1999 Review, expressed as a minimum differential between lower and higher premiums. Deloitte notes that without a requirement to provide insurance, price regulation could result in firms not offering insurance to certain firms.

A third policy option would be to ask insurers to take on an 'assigned risk pool', as outlined in the 1999 Review. Insurers would be required to accept a certain number of high cost practitioners. This could be based on areas of practice or similar criteria. Another route to support higher-risk firms or practice areas would be for a direct government subsidy to Lawcover to support it to provide cover to firms who are higher risk, and therefore unable to obtain insurance from commercial insurers. This would support market coverage while allowing Lawcover to compete more vigorously in the parts of the market which are more commercially viable.

A fourth policy option would be for government to mandate a risk management activity levy. As envisaged in the 1999 Review, a percentage of premiums paid would go to the Law Society and they would be 'required to account for the funds in the annual reports.'

A fifth policy option would be the introduction of a market regulator with national oversight. This body would have the power to require providers to regularly submit data on aspects such as the criteria utilised in this report in the assessment of the current state, namely market affordability and accessibility, premium stability, market stability, market coverage, and the effectiveness of risk management. As a national body, the regulator would then be equipped to evaluate consistency in provider performance relative to these criteria across states, providing a degree of accountability for individual providers.

Additionally, a potential complementary policy option would be to loosen the requirements for solicitor firms to acquire coverage from providers based in their home state, which may offer a route to introducing more than one competitor outside of that outlined in Scenario 3. Currently, around 20% of solicitors operating in NSW acquire coverage from providers based elsewhere in Australia. This is permitted as these solicitors operate in more than one state, and so are free to select a provider based in any of the states in which they operate to cover the entirety of their operations. Further loosening the requirement for solicitors to acquire coverage from providers based in their home state could be explored, as this may offer a route to allow for greater competition between providers. This policy has not been evaluated in this report and would need to be carefully assessed to understand any potential adverse consequences for the market.

Finally, there may be value in providing some lead time in the period before market entry so that insurers are able to adjust to changed market circumstances.

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Appendix B: Overview of Solicitors' PII across Australian Jurisdictions

B.1. Legislative and regulatory overview

Each state in Australia has a Law Society as the professional regulator. Currently, all states and territories have one main provider of solicitors' PII. However, different arrangements exist for community legal centres. Firms operating in multiple Australian jurisdictions may use professional indemnity providers from other jurisdictions.

Table B.1: provides a list of approved insurers and statutory bodies in each Australian jurisdiction. Subsequent sections of this appendix provide further detail on arrangements in specific jurisdictions.

Table B.1: List of approved insurers for solicitors' PII in each Australian jurisdiction.

Jurisdiction	Approved insurers
ACT	• Lawcover Insurance Pty Ltd • The Legal Practitioners Liability Committee of VIC for firms with VIC and ACT offices only • Liberty International Underwriters for Community Legal centres
NSW	Lawcover Insurance Pty Ltd
NT	Lawcover Insurance Pty Ltd
QLD	Lexon insurance Pte Ltd (formerly QLS insurance)
VIC	• Legal Practitioners' Liability Committee (LPLC) for private practices • National Association of Community Legal centres for Community Legal centres • Victorian Managed Insurance Authority for Community Legal centres • National Pro Bono Resource Centre for corporate or government lawyers
SA	Law Claims
WA	Law Mutual (WA)
TAS	Marsh Pty Ltd (Broker)

Source: Deloitte.

B.1.2. Victoria

In Victoria, it is compulsory for solicitors to obtain PII cover of $1.5 million per claim in order to practice, as prescribed in the *Legal Practice Act 1996 (Vic)*. The Legal Practitioners' Liability Committee (LPLC), a statutory agency, is the sole provider of PII for private practices, and currently insures around 24,000 practitioners including both barristers and solicitors.

LPLC was established in 1986 prompted by challenges in securing appropriate terms from commercial insurers by the previous body organising insurance on behalf of Victorian solicitors. Since then, Victoria has continued with a sole provider model for solicitors, with both the 1998 Trowbridge report and 2004 PWC review recommending a single insurer market. The PWC review into the preferred provider arrangement for PII identified that a single provider model would be more likely to result in high quality cover at affordable prices, compared to a multiple provider model.

In a 2014 submission to the Senate, LPLC asserted that it was able to offer higher quality and more comprehensive cover than a private market.[39] The LPLC additionally claimed that they were able to provide lower and more stable premiums given that their status as a statutory monopoly did not require them to make a profit. The LPLC also referred to their lower administrative and management fees (expenses not incurred for advertising, underwriting, brokerage), as well as access to good information about risk in the market to explain their ability to cover at a high loss ratio.

B.1.3. Queensland

In Queensland, law practices must obtain PII from the Queensland Law Society (QLS) managed PII scheme. Established in 2001, Lexon Insurance Pte Ltd (Lexon) is the captive insurer for the scheme. Lexon is wholly owned by Queensland Law Society and provides coverage of $2 million per claim. Prior to 2001, PII providers varied from the UK retail market prior to 1987, to APPIIL and St Paul Insurance Australia Ltd.

In 2022, Lexon insured 8,850 practitioners with approximately 1,000 working in other jurisdictions. Lexon has reported that their investment into risk management means that they are able to maintain low claim values despite increases in file numbers. They have also noted that as a stable and well-run insurer, they have the capacity to reduce levies for the profession when necessary instead of passing costs onto customers.[40]

QLS noted that the current PII structure provides significant benefits to the legal industry in a 2014 submission to the Productivity Commission on access to justice.[41] The submission cites that the scheme is able to provide broader coverage than the commercial market, with features such as free run off cover for former practitioners and non-disclosure waivers. Reviews by Aon Risk services have also concluded that a strength of the Lexon model is that their universal insurance policy ensures that smaller practitioners are able obtain insurance at an affordable price, which would not be the case in a commercial market.

B.1.4. South Australia

In South Australia, solicitors must hold PII provided by the South Australian Legal Practitioners Professional Indemnity Scheme. The Scheme is administered by Law Claims, a subsidiary of the Law Society of South Australia, and covers practices up to $2 million per claim.

B.1.5. Northern Territory

Under section 376 of the *Legal Profession Act 2006 (NT)*, solicitors must obtain PII with an insurer approved by the Law Society of the NT.[42] Since 2020, Lawcover has been the sole provider of PII. Lawcover was appointed by the Law Society following continued premium increases by the previous underwriter, QBE.

B.1.6. ACT

In the ACT, section 311(1) of the *Legal Profession Act 2006 (ACT)* mandates that practicing solicitors must hold an approved professional indemnity policy with a minimum PII cover of $1.5 million per claim.[43] PII is managed by the Law Society of ACT, with two approved insurance policies currently available to law practices:

- Lawcover Insurance Pty Ltd
- The Legal Practitioners Liability Committee of Victoria (LPLC) (in respect only of firms who have an office in Victoria in addition to their office in the ACT)

Prior to May 2021, Gallagher (underwritten by Liberty Mutual and previously QBE) also provided insurance, capturing 35% of the market behind Lawcover (56% of the market). LPLC insured 0.9%

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39 Legal Practitioners' Liability Committee 2014, 'Access to Justice Arrangements: Submission to the Draft Productivity Commission Report, Draft Recommendation 7.3'.
40 Young, M 2020, 'Lexon End of Financial Year Review', QLS Proctor, 1 September, https://www.qlsproctor.com.au/2020/09/end-of-financial-year-review/.
41 Queensland Law Society 2014, Productivity Commission Draft Report - Access to Justice Arrangements.
42 Legal Profession Act 2006 (NT) s376.
43 Legal Profession Act 2006 (ACT) s311(1).

of practices. However, Gallagher withdrew from underwriting ACT solicitors in May 2021. As a result, 77% of ex-Gallagher practices renewed with Lawcover, with the remaining practices opting for LPLC.

B.1.7. Western Australia

In Western Australia, legal practitioners and legal practices must hold an approved insurance policy in order to engage in legal practice, pursuant to section 211 of the *Legal Profession Uniform Law (WA)*.[44] The PII arrangement has been administered by Law Mutual since 1995, on behalf of the Law Society of WA. Law practices are covered under a Master Policy, and pay an annual contribution and an administration levy to receive cover of up to $2 million per claim.

B.1.8. Tasmania

In Tasmania, PII requirements for solicitors in Tasmania are prescribed by the *Legal Profession Act 1993 (Tas).* Solicitors must obtain PII cover through the Law Society of Tasmania Professional Indemnity Scheme if they would like to practice. The scheme covers solicitors of up to $2 million per claim, though optional higher limits are available to purchase. The Law Society of Tasmania has appointed Marsh Pty Ltd as the approved broker.

For 2024/2025, the premium for a full-time practitioner is $4,103. Reduced premiums are available to sole practitioners who earn below $50,000.[45]

44 Legal Profession Uniform Law (WA) s211.

45 The Law Society of Tasmania 2024, 'Professional Indemnity Insurance Master Policy Schedule For The Period 1 July 2024 To 30 June 2025', < https://www.lst.org.au/wp-content/uploads/2024/07/Tas-Law-Society-Master-Policy-Schedule-2024-2025-no-premium>.

Appendix C: International Markets for Solicitors' PII

C.1. England & Wales: Solicitors' PII

The Solicitors Act of 1974 first introduced a mandatory insurance requirement for solicitors in England and Wales, with this requirement primarily intended to serve the dual function of protecting clients against negligence, and protecting solicitors from the financial consequences of successful negligence claims. The formulation of this requirement provided The Council of the Law Society with three options for implantation:

a) That the Society established and maintained a fund to cover indemnities;
b) That the Society took out and maintained insurance with authorised insurers; or
c) That the Society required solicitors to individually take out and maintain insurance with an authorised insurer.

The Society selected option (b) and introduced what was known as the Master Policy scheme. Under this scheme, the Society negotiated a master insurance policy for the solicitor profession as a whole, under which it issued insurance certificates to individual firms.

This allowed for economies of scale in the calculation of premium pricing, while it also allowed the Society to ensure all practising solicitors were able to obtain cover. The Master Policy scheme was operational between November 1975 and August 1987, at which point the Society opted to transition to option (a), establishing the Solicitors Indemnity Fund (SIL) as a Law Society-owned vehicle to provide cover on behalf of the profession. This transition was intended to reduce premiums, ensuring that the solicitors profession covered only its own risks rather than being exposed to cross—subsidisation of other insurance markets, while also saving the profit margin which the insurer had previously captured.

The SIF operated as the exclusive provider of insurance to the profession from 1987 until 2000, although from 1997 onwards the fund struggled as a result of miscalculations in the predication of future claims. In January 1997, it was estimated that the fund needed to raise an additional £248 million to remain solvent. However, by June 1997 this shortfall had risen to an anticipated £454.4 million, leading The Council of the Law Society to implement a 50% increase in contributions, with a further proposal to introduce an additional 30% increase heard in March 1998.[46] These increases in premiums risked forcing solicitor firms to exit the market due to the unsustainable cost of cover.

Disillusioned with the fund, members of the profession voted in 2000 to decide its fate: a 70 per cent majority supported a return to buying insurance in the open insurance market. Competitive markets have been in place ever since.

Since 2000, the PII market for solicitors in the UK has remained volatile. In response, the Assigned Risks Pool (ARP), which provides coverage for hard-to-insure firms, became in high demand. However, as risks increased, the ARP closed its doors to new applications as it became evident that a significant number of UK firms would face closure, even if permitted to join the ARPs, which offered coverage at very high prices. This closure marked a significant shift in the landscape of PII for solicitors, requiring firms to rely entirely on the open market for coverage, thereby amplifying the challenges associated with obtaining adequate insurance protection.

46 Davies, M. 1998, 'Wither mutuality? A recent history of solicitors' professional indemnity insurance', *International Journal of the Legal Profession* 5:29-61.

England and Wales now has 51 approved insurers as of 2023/24 (up from 46 in 2022/23). Its recent experience has been characterised by high and increasing premiums as long tail claims reveal that PII has been underpriced for years. In particular, the distribution of premiums varies considerably based on firm size, area of practice and number of claims.

C.1.1. Current Regulatory Situation

In England and Wales, the Law Society serves as the professional body representing solicitors, providing support, guidance, and advocacy for its members. Meanwhile, the Solicitors Regulation Authority (SRA) operates independently to regulate solicitors and law firms, ensuring adherence to professional standards and ethics. While distinct entities, they work closely to maintain the integrity and quality of legal practice.

All Solicitors Regulation Authority (SRA) authorised firms must have a valid PII policy to be able to carry on a practice. When arranging cover, lawyers must make sure that it meets SRA's minimum terms and conditions.[47] In addition, it should be 'adequate and appropriate' insurance. The appropriate level and scope of insurance coverage for solicitors or firms vary depending on individual circumstances.[48] These circumstances include client profile, types of matters handled, historical claims experience, and potential maximum losses. Freelance solicitors or non-commercial bodies providing reserved legal services must also ensure adequate insurance. Assessing adequacy involves considering factors like claims history, alternative coverage arrangements, and transparency in client communications.

PII operates on a "claims made" basis, covering claims made during the policy period, even for past services. While no specific run-off cover level is mandated, solicitors should plan for potential claims post-practice cessation to ensure adequate coverage.

C.1.2. Participating Insurers

Participating insurers in the UK are authorised by the Financial Conduct Authority (FCA) and sign an agreement with the Solicitors Regulation Authority (SRA). This agreement mandates them to offer a minimum level of coverage set by the SRA, regardless of policy wording.[49] The FCA or relevant foreign financial regulators oversee the regulation of participating insurers, as the SRA does not conduct additional vetting or solvency checks. However, the SRA requires insurers to disclose their financial security rating, promoting transparency for consumers. As of 2023/2024, there are 51 participating insurers listed on the SRA website.

C.1.3. Applying for PII

Applying for PII is onerous. First, law firms need to talk to brokers as this is the only way to deal with insurers for most firms. Large firms can usually get insurance through one broker, but smaller practices may need more than one to access all the insurers who can offer them PII.

Secondly, the trend in recent years has been for the insurers to request more information, especially if firms are working in a perceived high-risk area such as conveyancing, probate or personal injury. Thirdly, there is a self-assessment obligation, where firms have to select the best cover for them in consultation with broker and insurer.[50] Is not necessary to buy all of a firm's cover from one insurer.

Firms in the UK that fail to renew their professional liability insurance enter the Extended Policy Period (EPP), during which their last-named insurer provides further indemnity cover for 90 days. Within 5 business days of entering the EPP, firms must inform the Solicitors Regulation Authority (SRA). While in the EPP, firms can't take on new business after 30 days but must make arrangements for orderly closure if unable to secure new insurance by the end of the 90-day period. Firms in the

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47 Solicitors Regulation Authority n.d., SRA Indemnity Insurance Rules, <http://www.sra.org.uk/solicitors/standards-regulations/indemnity-insurance-rules/>.
48 Solicitors Regulation Authority n.d., *Guidance*, < https://www.sra.org.uk/solicitors/guidance/adequate-and-appropriate-indemnity-insurance/>.
49 Solicitors Regulation Authority n.d., *SRA Indemnity Insurance Rules*, <http://www.sra.org.uk/solicitors/standards-regulations/indemnity-insurance-rules/>.
50 The Law Society of New South Wales 2023, *Professional indemnity insurance*, <Professional indemnity insurance | The Law Society>.

EPP also need to notify the SRA of their insurance status, including any backdated policies obtained. Compliance with these requirements is mandated by the Indemnity Insurance Rules.

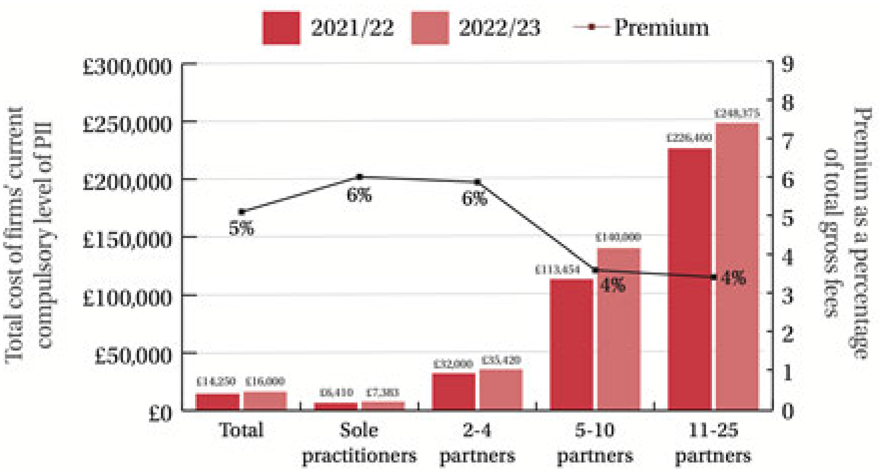
C.1.4. Current Claims Experience

While the solicitors' PII market in England and Wales has generally experienced a degree of volatility, harder market conditions since 2018 have been challenging to endure for the legal sector. In the last few years, reduced capacity within a shrinking insurance market have driven premium prices significantly higher. Recessionary conditions and insolvencies have triggered fears that more claims will be brought against practices, increasing the risk aversion of the insurance market. With financial pressures already mounting from the economic downturn, this hardened market has resulted in 37 law firms closing in the 12 months leading up to 30 June 2022, and 9 more before 1 October 2023 due to being unable to secure PII cover.[51] With increased PII costs likely being passed on to consumers, there are fears that there will be diminished access to justice resulting from the reduced availability of legal services.

However, PII insurers have reported that premium rates have held stable or declined during the April 2024 PII renewal cycle, indicating softening market conditions. Proposed contributors to this slight increase in stability include greater competition in the insurance market and improved capacity amongst insurers in the last few months. Responsible lending practices coupled with a downturn in the property market has also led insurers to expect fewer conveyancing claims, stabilising rates for conveyancing firms.[52]

Affordability of PII for practices substantially varies depending on the size of a firm and type of work engaged in. The median excess on claims is £5,000, with larger firms facing substantially higher figures. Firms may agree to higher excesses to secure cover or lower premiums from underwriters. The median cost of PII cover is £16,000, an increase of 29% from FY18.[53] The median premium rate sits at 5% of annual turnover.[54] As shown in Figure C.1: premiums as a share of gross fee income are higher for smaller firms although the decline in this figure for large firms is less pronounced than observed in Australian jurisdictions where this information is available e.g. NSW or Western Australia.

Figure C.1: Premiums by firm size in England and Wales



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51 Hyde, J 2023, 'Firms go under as PII premiums soar to 20% of turnover', The Law Society Gazette, 16 January, <https://www.lawgazette.co.uk/firms-go-under-as-pii-premiums-soar-to-20-of-turnover/5114792.article>.

52 Reyes, E 2024, 'Greater competition between insurers softens PII market', The Law Society Gazette, 8 March, <https://www.lawgazette.co.uk/news/greater-competition-between-insurers-softens-pii-market/5119000.article>.

53 The Law Society 2023, 'Latest trends in professional indemnity insurance for law firms', available from: https://shirepf.co.uk/wp-content/uploads/2023/08/PII-Report-Summary-2023.pdf.

54 Frontier Economics 2023, Econometric Analysis of Professional Indemnity Insurance Costs for Legal Service Providers.

Source: The Law Society 2023.

In general, with high-risk specialties excluded, PII premiums range between 3% to 9% of a firm's annual turnover. Small law firms and sole practitioners pay almost double the rate of large law firms (6.7% vs 3.7% respectively). Reluctance by the market to insure smaller firms stems from the expectation that they are higher risk and likely have lower capital levels. A similar trend is observable for certain legal specialties. Practices with 60% of their work in conveyancing pay double the rate compared to practices with only 30% of their work in conveyancing. Firms that specialise in property pay a median premium rate of 8%.[55]

While the insurance market is competitive, it is dominated by Travelers (34% of the market share) and Sompo International (19% of the market share). Despite the multiple provider structure, the 2023 Law Society survey found that the majority of firms (80%) approached only one insurer for a quote when renewing their PII, and only 13% have switched insurers from their last renewal cycle. Of the firms that switched, two-thirds paid a higher premium than with their previous insurer, indicating that they were unable to source better deals.[56] Although 20% of firms reported purchasing top-up cover, the indemnity limits have decreased since the previous policy period. Some 56% of the firms that purchased top-up cover have policies worth more than £3m above their primary layer cover, compared with 65% previously.

The Law Society has been receiving reports that a growing trend in the insurance market involves certain insurers demanding personal guarantees from solicitors, increasing their risk exposure.[57] These guarantees entail directors of law firms pledging personal assets to repay business debts.

C.2. Scotland: Solicitors' PII

In Scotland, solicitors' PII arrangements follow a master policy approach, unlike the system in England & Wales overseen by the SRA. In England & Wales, the SRA establishes rules and minimum standards for authorised firms to procure and sustain PII, with firms having the option to obtain insurance from various 'Participating Insurers' adhering to the regulator's prescribed terms and conditions.

The Law Society in Scotland notes that Scottish solicitors pay considerably less for higher cover by comparison to their counterparts in England and Wales, due to the collective buying power of the Master Policy approach.[58] Under the terms and conditions of the Master Policy, every Scottish legal firm, irrespective of size, business profile or claims record, will be provided with a quote under the Master Policy. That is not necessarily the position for firms in England & Wales who could find they either cannot source cover at an affordable price, or in some cases, obtain a quote for cover at all.

C.2.1. Current Regulatory Situation

The Law Society of Scotland has the statutory power to maintain PII arrangements for all practising solicitors in Scotland. The Law Society of Scotland has elected to do this by means of a Master Policy negotiated with an insurance broker. The Master Policy is a single compulsory collective PII scheme for all private practices of Scottish solicitors.

The role of the company appointed to be brokers for the Master Policy is primarily:

- To negotiate with insurance markets each year to ensure that the Master Policy is renewed on as competitive and sustainable terms as possible
- To administer the Master Policy renewal process to the service requirements set down by the Law Society

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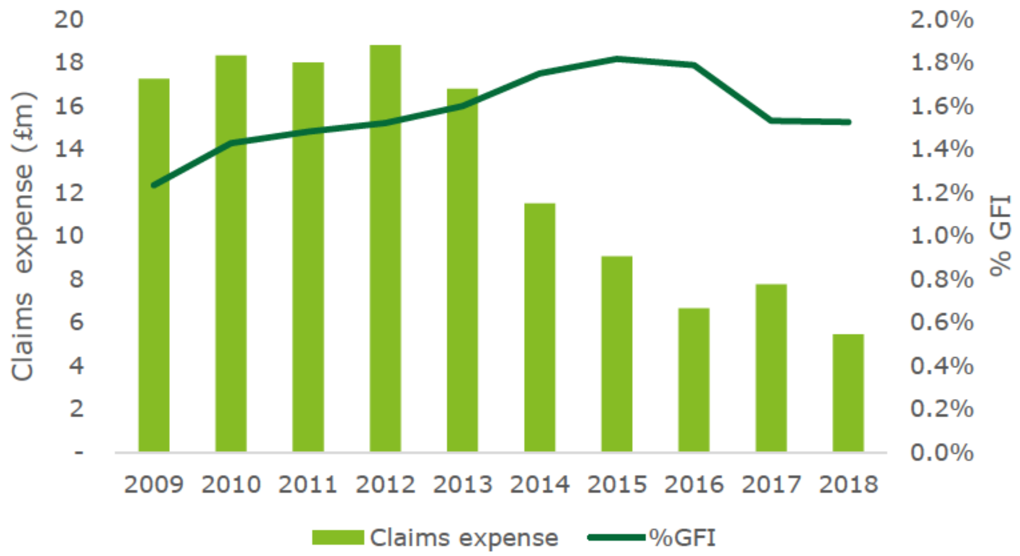
55 Ibid.
56 The Law society 2023, 'Latest trends in professional indemnity insurance for law firms: appendix'.
57 Gazette newsdesk 2023, 'News focus: trends in professional indemnity insurance 2023 - main findings', The Law Society Gazette, 21 July, < https://www.lawgazette.co.uk/news-focus/news-focus-trends-in-professional-indemnity-insurance-2023-main-findings/5116726.article>.
58 Scottish Legal Complaints Commission 2021, 'Master Policy Professional Indemnity Arrangements: A report by the SLCC following the retender exercise carried out by the Law Society of Scotland'.

- To provide advice and guidance to the solicitor profession on risk management

The broker arranges for the Master Policy to be underwritten by insurers, monitors the performance of insurers, accepts notification of Master Policy claims, refers claims to insurers, and investigates any complaints concerning insurers' conduct of claims. The broker does not have a direct role in the handling of individual claims, which are allocated to insurers, who handle claims according to the Master Policy Claims Handling Philosophy.

The latest statistics that Deloitte could find is the Lockton Law Master Report of 2017/2018, published in July 2019. While these statistics are broadly representative, it should be acknowledged that in the proceeding years the global PII and global solicitors' PII market experienced a considerable hardening.

Figure C.2: Claims expenses and premiums as a share of GFI (% GFI) in Scotland



Source: Deloitte

In terms of pricing, Figure C.2: shows the trajectory of claims expenses within the period of 2009 to 2018 reveals a notable decline, dropping from approximately £20 million to £6 million. This downward trend signifies a significant alleviation in financial burden for firms, potentially indicating improved risk management practices or favourable market conditions. Concurrently, premiums as a proportion of Gross Fee Income (GFI) have remained relatively stable over this same timeframe. Compared to the UK's GFI of 5% in 2021/22 this performance reflects a commendable outcome.

Appendix D: Alternative Australian PII Markets

D.1. Scope of comparable markets

Different professions have different experiences with PII, based on the differences in the key features of PII as well as differences in the nature of each profession. This analysis looks at four professions within Australia: barristers, engineers, medical practitioners and accountants. Each offers valuable lessons for the design of the NSW solicitors' PII market.

Comparing PII across different markets poses challenges due to the limited availability of clear data. This lack of transparency makes it difficult to directly compare aspects such as premiums and claims in the same time periods. Consequently, comparisons between markets typically rely on qualitative or secondary evidence regarding premiums and claims, hindering the ability to draw definitive conclusions or discern clear trends across markets. Factors such as regulatory frameworks, market structures, and government involvement can still be compared.

D.2. Barristers

PII is a statutory requirement for all barristers in New South Wales. The attorney general, pursuant to section 95 of the Legal Profession Law Application Act 2014, approves the type of PII policies, the level of insurance provided by the policies and the terms of the policies which can be offered to the NSW Bar.

For the 2021-22 practising year, the minimum level of PII insurance that a NSW barrister must take out is $1.5 million.

Based on info from NSW Bar Association, there are four providers of PII for Barristers.[59] These are:

- AON (CGU): Aon is a private insurance brokerage firm. While Aon itself is not an insurer, it works with various insurance companies, including CGU (which is a subsidiary of Insurance Australia Group Limited), to offer PII and other types of coverage. CGU is a private insurer.
- Arch Underwriting on behalf of certain Lloyd's underwriters (Marsh): Arch Underwriting and Lloyd's underwriters operate as private insurance providers. Marsh, on the other hand, is a private insurance brokerage firm that works with various insurers, including Lloyd's underwriters, to offer PII and other insurance products.
- Suncorp: Suncorp is a private insurance company. It offers a wide range of insurance products and services to individuals and businesses, including PII.
- Pacific indemnity (Austbrokers): Pacific Indemnity is a private insurance company. Austbrokers is a network of insurance brokers that operates as a private entity. Pacific Indemnity, through Austbrokers, provides PII and other insurance solutions.

As noted in Chapter 4 there are comparatively lower costs associated with barristers' PII when contrasted with their solicitor counterparts. This is primarily due to the distinct nature of their practice, where barristers typically are protected by advocate's immunity While limitations to this immunity exist, it generally shields barristers from being sued for negligence in relation to their conduct during court proceedings as a result of their duty to the court, thereby reducing the frequency and severity of claims against them. Consequently, insurers perceive barristers as posing lower risks, resulting in lower premiums compared to solicitors who lack this immunity.

59 New South Wales Bar Association n.d, Barristers' Pi Insurance: Rule 79 Requirements, Rule_79_table,_ https://nswbar.asn.au/uploads/pdf-documents/Rule_79_table_-_2023-2024.pdf.

D.3. Medical/Doctors

The Medical PII market is a competitive market, with insurers required to meet the *Medical Indemnity (Prudential Supervision and Product Standards) Act 2003 (Cth). The Medical Indemnity Act* also makes provision for minimum product standards for medical indemnity contracts – supervisory responsibility for these lies with the Australian Securities and Investments Commission. Medical insurers reinsure their policies to mitigate risk and ensure financial stability. The 2003 Act requirements include, among other things:

- compliance with APRA's liability valuation standards, which mandates the appointment of an actuary who estimates the liabilities and risk margin
- having risk management systems, including pricing and underwriting control mechanisms
- holding a minimum level of capital based on an assessment of identified risks (but subject to a minimum of $5 million)
- regular provision of data and reports.

Medical indemnity insurers include both Medical Defence Organisations (MDOs) and private, for profit insurers. MDOs are typically owned or operated by healthcare professionals, specialise in providing medical indemnity coverage and support services tailored to their members' needs, including legal advice and risk management. They operate on a mutual or not-for-profit basis, prioritising member support over profit generation. In contrast, private insurers, for-profit entities owned by shareholders, offer a broader range of insurance products beyond medical indemnity and may not provide as specialised or tailored services to healthcare professionals. While both MDOs and private insurers are subject to regulatory oversight, MDOs may have their own internal governance structures driven by their member base, whereas private insurers are regulated by government authorities like the Australian Prudential Regulation Authority (APRA).

Some of the main medical indemnity insurers in Australia are set out in Table D.1:

Table D.1: Medical Indemnity Insurers

Private Insurers	Medical Defence Organisations
Berkshire Hathaway (Tego Insurance)	Avant
Guild Insurance Limited	MDA National
	Medical Indemnity Protection Society Limited
	Medical Insurance Group Australia

Source: Deloitte

D.3.2. PII Coverage and registration requirements for medical practitioners

Practising Medical practitioners must be insured or indemnified for every context in which they practise. For private practice, insurance cover must include appropriate retroactive cover for otherwise uncovered matters arising from prior practice undertaken in Australia. For government employees or other indemnified employees, these can be covered in a master policy with the organisation.

Medical practitioners must ensure that their PII arrangements offer sufficient coverage, regardless of whether the registration standard sets a minimum level of cover. This means that their PII arrangements should match the specific nature, context, and risks associated with their practice. Practitioners should assess the potential risks stemming from their own practice and ensure that their PII arrangements provide adequate coverage to address those risks. APHRA considers practitioners to be in the best position, in consultation with insurers, professional bodies, unions to make the most informed decision about coverage levels.[60] Run-off cover is necessary for previous medical practice.[61]

D.3.3. History

In the period leading up to the Commonwealth's Professional Indemnity Review (PIR) (1995), many of the medical defence organisations (MDOs) were not insurers, though many doctors believed them to be. They retained a discretion whether or not to indemnify their members. They were therefore not subject to prudential regulation. The PIR found that many of them had not made sufficient provision for claims and their reserves were inadequate. There were many incurred but not reported incidents (IBNRs) that were likely to give rise to claims. It was necessary to increase premiums to catch up.

There was also a great deal of cross subsidisation, that is, all branches of the profession paid the same amount by way of premium.[62] When the MDOs moved to rating their members according to risk, the payments required of obstetricians, plastic surgeons, neurosurgeons and rural general practitioners who carried out high-risk procedures, increased considerably.

Further, the events of 11 September 2001 in the United States caused worldwide reinsurance rates to increase greatly. Insofar as the MDOs reinsured a portion of their risks, their costs similarly increased and had to be recouped through increases in premiums. Investment returns, which many insurers depended on to reduce the premiums they charged, declined and even became negative in the two proceeding years. Finally, the collapse of the HIH Group and, more particularly, of the largest MDO, United Medical Protection (UMP), inevitably led to rises in the premiums charged by others.

In 2003, estimating that UMP (an MDO) had accrued unfunded incurred but not reported claims of $460 million, to prevent a collapse of the Medical PII market.[63] Since 2003, the government has introduced a number of schemes to ensure smooth functioning of the PII market, discussed below.

D.3.4. Commonwealth support

The Commonwealth has introduced a number of schemes that help support Medical Practitioners by taking some risk away from the insurers or by supporting them directly.[64] They exemplify government intervening in a market where maintaining affordable coverage is essential.

Exceptional Claims Scheme (ECS)

The ECS provides additional protection for medical practitioners against personal liability for claims exceeding their insurance cover. The government assumes liability for damages above the practitioner's insurance limit, as long as the practitioner has coverage equal to or above a specified threshold amount, currently set at $20 million. ECS can be activated by a single large claim or an aggregate of claims exceeding the threshold. It is subject to periodic review.

Run-off Cover Scheme (ROCS)

ROCS addresses concerns within the medical profession regarding retired doctors' ability to afford run-off cover. It requires insurers to provide run-off cover for eligible doctors, ensuring coverage similar to their last insurance contract. The government covers the cost of claims under this scheme. ROCS is funded by a levy on insurers and guarantees secure indemnity cover for eligible doctors.

High Cost Claims Scheme (HCCS)

The HCCS aims to reduce the financial burden on insurers by reimbursing them 50% of the cost of large claims exceeding a threshold amount. This scheme applies to claims notified on or after January 1, 2003.

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60 AHPRA 2016, 'Fact sheet: Professional indemnity insurance arrangements'.
61 Medical Board of Australia 2016, Registration Standard: Professional Indemnity Insurance Arrangements'.
62 ACCC 2009, 'Medical indemnity insurance: sixth monitoring report'.
63 Ibid.
64 Ibid.

Premium Support Scheme (PSS)
The PSS assists eligible doctors with medical PII costs by reducing premiums. It replaces the Medical Indemnity Subsidy Scheme (MISS) and applies to doctors whose indemnity costs exceed 7.5% of their gross private medical income.

Midwife Professional Indemnity Scheme (MPIS)
MPIS is available for eligible midwives and supports the medical indemnity insurer by reimbursing 80% of a part of a claim between $100,000 and $2 million, as well as 100% of any part of claim exceeding $2 million. The insurer must cover the first $100,000.

Tort Law Reform
Tort law reforms have been implemented by federal, state, and territory governments since 2001 to address concerns about insurance availability and affordability. Reforms include caps on damages, thresholds for accessing damages, changes in limitation periods, and adjustments to discount rates for claims payouts. These reforms impact the cost of medical PII.

D.3.5. Claim stability and premium prices

Evaluation of data on claim stability, number of policies, premium income and capital levels of insurers from 2007 to 2019 indicate that the medical PII market has been largely stable in recent years. The number of medical PII policies has increased by 20,000 (from 70,000 in 2007 to 90,000 in 2019). Premium income for insurers has also steadily grown between 2015 to 2019. The medical PII industry has maintained a strong capital position above minimum capital requirements set by APRA, resulting in members receiving additional financial benefits such as reduced premiums or dividends paid on retirement.

Stability of claims can be measured by using a gross loss ratio. From 2011 to 2018, the industry average gross loss ratio has remained steady, at a rate below 100%. However, from 2018 onwards, a slight increase to above 100% is visible.[65]

HCCS and MPIS act as a form of reinsurance and contributes to stability in the market. Thus, a net loss ratio could be used to understand how reinsurance including government schemes affect claim stability. While the net loss ratio reflects a similar steady but upwards trend much like the gross loss ratio, it remains consistently lower than the gross loss ratio. A similar chart completed for HCCS shows that HCCS reduces supports the stability of the medical PII industry by reducing net claims costs, subsequently reducing insurance premiums for practices.

Analysis of the general insurance industry shows that in the past five years leading up to 2019, insurers have remained profitable, achieving an average net profit of 6.9%. Net incurred claims have been on average 68% of net earned premium, indicating general stability.[66]

Medical PII premiums have become more affordable for practices. From 2007 to 2019, median nominal premium has steadily increased to under $6,000 while, the median real premium has largely remained steady at around $4,000.[67] However, membership fees are a substantial add-on cost on top of premiums and have consistently grown in the same period. In 2019, the median premium for a private practice was 2.5% of income, a decrease of 0.6 percentage points from 2007.[68] This decline in premiums as a proportion of income is reflected across most of the industry, particularly for high-cost specialties. In general, insurers charge practices premiums under 10% of their income (95% of policies). A decline in PSS recipients is further indication of premium affordability.

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65 Australian Government Actuary 2020, Evaluation of the Stability & Affordability of Medical Indemnity Insurance, <http://aga.gov.au/sites/aga.gov.au/files/sites/aga.gov.au/files/publications/2020-11/mii_actuarial_review.pdf>.
66 Ibid.
67 Ibid.
68 Ibid.

D.4. Accountants

Accounting is distinct from Solicitors, Barristers and Medical Professionals as the requirement for accountants to hold PII is imposed contractually by the relevant professional association as a condition of membership of that association, typically when the member holds a public practice certificate issued by the relevant body. While each association may partner with a broker to provide their members a PII option, practices are able to select their own insurance policies, subject to the association's by-laws. For example, CPA Australia has partnered with Marsh Insurance but notes that it does endorse any supplier or product. CA ANZ has partnered with both Marsh and Aon Risk Services.

Different associations have different requirements for monetary ceilings. While the monetary ceiling for ATMA and IPA members is $1 million, CPA Australia and CA ANZ set limits using complex measures, including the income and size of firm. For CPA Australia members, the range for minimum sum insured is from $2 million to $75 million, for practices with 60 or more principals and income of more than $20 million. For CA ANZ members, band limits are set according to fee for the service. Category 1 services have limits from $2 million to $75 million, while Category 2 and 3 services are subject to a range of limits from $2 million to $20 million.

Although there are several professional associations for accountants, information about risks is collected on a profession-wide basis and used to create risk management strategies and programs for the benefit of members. The intention is to improve professional practice and reduce the risk that clients will suffer loss.[69]

D.4.1. Pricing

As insurance providers often work closely with a professional association, there is a general expectation that all insurance applications will be accepted regardless of the risk, particularly if the applicant is a member. BizCover's 2019 survey of NSW accountants found that accounting firms earning less than $50,000 per month paid a premium of around $63 a month, while firms earning $200,000 or more per month had premiums of $170 a month. Similarly, the differences in monthly premiums between a sole trader and a firm with 5 employees was around $150.[70]

D.4.2. Volatility

In the last few years, accounting PII insurers have faced significant losses, causing a hardening of the Australian PII market. Exits from the market by international underwriters including several of Lloyd's syndicates have also resulted in a retraction in the number of participants willing to underwrite risks. A 2022 Taylor Fry report revealed that premium cost as a proportion of GFI increased at an annual rate of 7% to 20% from 2017 to 2020 for all CA ANZ band limits, with the exception of the $2 million to $5 million band. However, the report found that insurance was readily available for all PI limit bands under $20 million.

D.5. Engineers

Due to the substantial risks involved, insurance companies approach providing engineering Professional Indemnity coverage with a high level of caution. The insurance industry is highly regulated, and underwriters must adhere to strict guidelines when assessing the risk of potential policyholders. In the case of engineering businesses, underwriters face several challenges:

- **High levels of complexity**: Engineering businesses often operate in complex environments, which can make it difficult for underwriters to understand the full scope of the risks involved. For example, a company that designs and builds a new type of jet engine will face numerous potential hazards, from material failures to design flaws.
- **High levels of customization**: Engineering firms frequently work on highly customised projects, which can vary greatly from one project to the next. This customization can make

69 CPA Australia, 'Professional indemnity insurance fact sheet',< https://www.cpaaustralia.com.au/-/media/project/cpa/corporate/documents/public-practice/your-public-practice-firm/professional-indemnity-insurance/pii-factsheet-current.pdf>.
70 See < https://www.bizcover.com.au/accountant-professional-indemnity-cost/>.

it difficult for underwriters to assess the risks involved, as they may not have experience with the specific type of project in question.

- **Cost**: Insurance coverage for engineering firms can be costly due to the heightened risks involved. The premium required to adequately price the risk exposure can make it challenging for smaller or start-up companies to obtain coverage or the coverage limit they need to operate effectively.

D.5.1. Regulatory situation

Unlike other markets analysed, Engineers are not required to have PII to practice. Instead, having PII can also be a requirement for specific contracts and in certain jurisdictions, it can be a requirement for registration.[71]

The standards of cover of different PII policies vary. A PII policy is underwritten and issued on a "claims made" basis. PII is purchased as a new contract of insurance annually covering the engineer's current and retrospective services provided as a whole as distinct from a specific project.[72]

D.5.2. Claims data etc

Unlike Barristers, where no news seems to suggest the market is working fairly well, the engineering industry has lots of discourse. Currently one of the most pressing issues facing the engineering profession is the affordability and availability of PII, particularly across the building and construction industries.

Engineers Australia has been discussing this issue with members for some time. Engineers working as sole practitioners and/or for small-medium enterprises in the building and construction industry (in particular, civil, structural, geotechnical, façade, and fire safety) and the amusement park industry appear to be the most severely affected. Even where PII is available, unreasonable exclusions or limitations are being imposed and the premiums are much higher (some members who have no PII claims history have experienced a 600% annual premium increase in the last 2-3 years). The situation has seen work not able to be completed or the viability of some businesses affected to such an extent that they cease to operate.[73]

The Insurance Council of Australia stated that "the quality of output across the Australian building industry has seen increased claims exposure particularly in recent years."[74] This statement is supported by two surveys by the Building Commission NSW that examines the experience of NSW strata communities in dealing with serious building defects. The survey reveals concerning trends regarding serious defects in common property among buildings, with 53% of buildings surveyed reporting such issues, a notable increase from 39% in 2021. However, there's a positive trend in newer buildings, as defects in these structures are on the decline since 2020. Furthermore, the proportion of serious defects reported to regulators has more than doubled since 2021, with 34% of buildings reporting defects in 2023 compared to just 15% in 2021. Waterproofing and fire safety systems remain the most prevalent issues, accounting for 42% and 24% of defects respectively in 2023, although the prevalence of waterproofing defects has shown a decline in recent years.[75]

The Insurance Council of Australia noted that in the period 2017-2021, PII claims increased by 125% while premiums grew by 63%. This highlights that premiums have risen, however, those rises are not matching the cost of risk of the performance of services produced in that industry segment.[76] These recent increases were in part driven by underpricing in the past where rates were low and competition among insurers was high.[77] Engineers Australia has recognised that to address these

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71 Engineers Australia, 'Professional Indemnity Insurance', available from: https://www.engineeersaustralia.org.au/policy-and-advocacy/professional-indemnity-insurance.
72 Ibid.
73 Engineers Australia 2021, 'Professional indemnity insurance action plan'.
74Engineers Australia 2021, 'PI insurance in engineering: Beyond the rising premiums', available from: < https://createdigital.org.au/pi-insurance-in-engineering-beyond-the-rising-premiums/>.
75 Office of the Building Commissioner 2023, '2023 Strata Defects Survey Report'.
76Engineers Australia 2021, 'PI insurance in engineering: Beyond the rising premiums', available from: < https://createdigital.org.au/pi-insurance-in-engineering-beyond-the-rising-premiums/>.
77 Ibid.

issues there was a need to develop risk management protocols and promote a culture shift around risk allocations and accountability.[78]

78 Ibid.

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Appendix F: Premium analysis assumptions

This appendix sets out the key assumptions that under the scenario analysis in relation to changes in premiums in Chapters 5 and 6.

F.1. Premium analysis

F.1.1. Scenario A – ABC target lower risk firms

Table F.1: Scenario A premium analysis

Component of premium	Baseline	Short term		Long term	
	Lawcover	**LawCover**	**ABC**	**LawCover**	**ABC**
Claims Experience	100.0	105.0	95.0	105.0	95.0
Claims Management	7.0	7.4	6.0	7.0	6.0
Total claims costs	**107.0**	**112.4**	**101.0**	**112.0**	**101.0**
Acquisition Function	0.0	2.0	5.0	3.0	5.0
Administrative Function (General)	26.5	26.5	21.7	23.8	17.0
Risk Management Expense	1.2	1.2	0.6	1.2	0.6
Reinsurance	16.1	16.1	16.1	16.1	16.1
Investment Returns	(11.0)	(11.0)	(11.0)	(11.0)	(11.0)
Total Insurance cost	**139.8**	**147.2**	**133.5**	**145.1**	**128.7**
Net Profit Loading	0.0	0.0	(1.0)	0.0	12.9
Total premium cost	**139.8**	**147.2**	**132.5**	**145.1**	**141.6**

Claim Experience

- Given ABC will target the more favourable risks from medium to larger practices, Deloitte assume that for a given level of cover, they would experience improved claims costs for equivalent risks.
- Deloitte has assumed that ABC's claims experience will improve by 5% in comparison to the baseline position. Lawcover's remaining portfolio will be for high-risk law practices, Deloitte has therefore assumed that their claims experience will worsen by 5% from the baseline position.
- This assumption will depend greatly on the level of cross subsidisation in Lawcover's portfolio and ABC's ability to target low risk segments relative to premiums paid.

Claim management expenses

- Baseline claims management expense is selected at 7% of claims costs which is in line with what Deloitte has observed in the market for insurers of a similar nature.
- Lawcover to be consistent in the short term and experience a 10% efficiency gain in the long term.
- ABC to be 10% more efficient in the short and long term.

Acquisition Function

- Acquisition function relates to costs of marketing, attracting and underwriting new business which is 0 for the baseline given Lawcover is the sole provider of solicitors PI.
- Industry statistics show an average acquisition expense of 5% of claims cost. Deloitte assume ABC will enter the market and maintain at this level.
- Lawcover are assumed to increase their acquisition cost. However, given they are established provider in the market Deloitte do not expect them to spend to the same level as ABC.

Risk Management Expense

- Deloitte used Finity's report "Review of Risk Management Impact- Lawcover FINAL (unsec).pdf", to estimate the risk margin expense for the baseline position.
- Deloitte assume that Lawcover will maintain a consistent spend on risk management incentives over the short and long term.
- Given ABC are targeting lower risk firms, they will likely not have the same requirement to implement reactive risk management incentives for firms that are exhibiting poor claims experience. Deloitte has therefore assumed that there spend on risk management incentives will equate to half of Lawcover's.

Net Reinsurance Cost

- Deloitte has considered Lawcover's APRA data on outwards reinsurance cost and reinsurance recoveries per gross claims incurred over the last 10 years to estimate the cost of reinsurance per $ claim.
- Deloitte has assumed that the net reinsurance loading component of the premium applied by Lawcover in their pricing will be consistent in the short and long term.
- ABC are backed by Liberty who are a well-established insurer who Deloitte would expect would have superior access to lower reinsurance rates in the reinsurance market. Deloitte has assumed that this may be offset by increased volatility in ABC's claim experience due to lower business volumes increasing reinsurance rates. Deloitte has therefore assumed that net reinsurance costs would be consistent between the two entities.

Investment Returns

- Deloitte has estimated the baseline position investment return component based on Lawcover's APRA statistics.
- Deloitte assume that both insurers will have access to the same investment markets and do not expect their forward-looking investment return assumption to be dissimilar. Deloitte has therefore assumed this component to be consistent between Lawcover and ABC.

Net Profit Loading

- Lawcover's combined ratio over the past number of years supports that they do not apply a profit loading.
- ABC' profit loading is set at 10%.

F.1.2. Scenario B – ABC targets all law firms

Table F.2: Scenario B premium analysis

Component of premium	Baseline	Short term		Long term	
	Lawcover	LawCover	ABC	LawCover	ABC
Claims Experience	100.0	100.0	100.0	100.0	100.0
Claims Management	7.0	7.0	6.3	6.7	6.0
Total claims costs	**107.0**	**107.0**	**106.3**	**106.7**	**106.0**
Acquisition Function	0.0	2.0	5.0	3.0	5.0
Administrative Function (General)	26.5	26.5	21.7	23.8	17.0
Risk Management Expense	1.2	1.2	1.2	1.2	1.2
Reinsurance	16.1	16.1	16.1	16.9	16.9
Investment Returns	(11.0)	(11.0)	(11.0)	(11.0)	(11.0)
Total Insurance cost	**139.8**	**141.8**	**139.4**	**140.6**	**135.1**
Net Profit Loading	0.0	0.0	(12.0)	0.0	13.5
Total premium cost	**139.8**	**141.8**	**127.4**	**140.6**	**148.6**

Baseline assumptions are in line with scenario A.

Claim Experience

- ABC will target all law firms. A mix of favourable and unfavourable risks will switch providers. Thus, claims experience will be consistent between both providers.
- Deloitte expect risk management incentives to be maintained keeping claims experience constant over the short to long term.

Claim management expenses

- Lawcover to be consistent in the short term and experience a 10% efficiency gain in the long term.
- ABC to be 10% more efficient in the short and 15% more efficient long term as they experience economies of scale.

Acquisition Function

- Industry statistics show an average acquisition expense of 5% of claims cost. Deloitte assume ABC will enter the market and maintain at this level.
- Lawcover are assumed to increase their acquisition cost. However, given they are established provider in the market Deloitte do not expect them to spend to the same level as ABC.

Risk Management Expense

- ABC and Lawcover are assumed to have a similar mix of unfavourable risks in their portfolio. Deloitte therefore assume that risk management costs will be consistent between both insurers and will be maintained over the long term.

Net Reinsurance Cost

- Assumptions and reasoning consistent with net reinsurance cost under scenario A.

Investment Returns

- Assumptions and reasoning consistent with investment return under scenario A.

Net Profit Loading

- Lawcover's continue to be not for profit.
- ABC's profit loading is set at 10%

F.1.3. Scenario C: an open market

Table F.3: Scenario C – Multiple new market entrants premium analysis

Component of premium	Baseline	Short term		Long term	
	Lawcover	LawCover	New Entrants	LawCover	New Entrants
Claims Experience	100.0	100.0	100.0	103.2	103.2
Claims Management	7.0	7.0	7.0	6.5	6.5
Total claims costs	**107.0**	**107.0**	**107.0**	**109.7**	**109.7**
Acquisition Function	0.0	5.0	10.0	8.0	8.0
Administrative Function (General)	26.5	26.5	22.5	23.8	18.5
Risk Management Expense	1.2	0.0	0.0	0.0	0.0
Reinsurance	16.1	16.1	16.1	16.9	16.9
Investment Returns	(11.0)	(11.0)	(11.0)	(11.0)	(11.0)
Total Insurance cost	**139.8**	**143.6**	**144.6**	**147.4**	**142.2**
Net Profit Loading	0.0	0.0	(15.0)	0.0	14.2
Total premium cost	**139.8**	**143.6**	**129.6**	**147.4**	**156.4**

Baseline assumptions are in line with scenario A & B.

Claim Experience

- New entrants will target all law firms. They will likely not have access to information to net target favourable risks relative to premiums paid. A mix of favourable and unfavourable risks will switch providers. Thus, claims experience will be consistent between all providers on average.
- Deloitte do not expect risk management expenses to be maintained due firms being easily able to switch providers. Therefore, Deloitte assume that any savings that were attributed to risk management will be reversed over the long term.

Claim management expenses

- Providers will not achieve the same level of economies of scale due to more providers in the market. Deloitte has assumed no efficiency gains in the short term.
- In the long term, Deloitte expect a competitive environment increase efficiencies and have allowed for all providers to become 10% more efficient.

Acquisition Function

- Insurers entering the market will need to spend a significant amount on acquisition costs to gain a market share in a scenario where there are multiple new entrants in the market. Deloitte expect that new entrants would need to spend double (per $ baseline claim) a single market entrant in scenario A&B. This is driven by:

  - New entrants need to market sufficiently to stand out among numerous other new entrants.
  - Less economies of scale experience by a market entrant in an open market than in a duopoly.
- Lawcover will also need to market more aggressively in an open market although not to the same extent as unestablished new market entrants. Deloitte expect Lawcover to increase spend on acquisition costs to a level that is in line with a commercial average in the short term.

Risk Management Expense

- In an open market, it is unlikely that firms will invest in risk management incentives due to the heightened risk of firms switching providers given the increased number of options available. Insurers are less likely to invest in risk management if they believe they will not experience the benefits of their investment should a firm move to a different provider in subsequent years. This logic also applies to Lawcover. Therefore, Deloitte assume that neither Lawcover nor new entrants will continue to invest in risk management incentives.

Net Reinsurance Cost

- Assumptions and reasoning consistent with net reinsurance cost under scenario A & B.

Investment Returns

- Assumptions and reasoning consistent with investment return under scenario A & B.

Net Profit Loading

- Lawcover's continue to be not for profit.
- ABC' profit loading is set at 10%.

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